

**PROSPECTS FOR THE
INTRODUCTION OF THE
VALUE-BASED PROPERTY
TAX IN HUNGARY**

DISCUSSION PAPER

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PROSPECTS FOR THE INTRODUCTION OF THE VALUE-BASED PROPERTY TAX IN HUNGARY

DISCUSSION PAPER

INTRODUCTION¹

This paper has been prepared to assist Hungarian local governments in decisions regarding local taxation and to alleviate concerns regarding the feasibility of the value-based residential property tax. In accordance with international taxation practice, this tax must take its place in local taxation, where it can expand the tax base of local governments and provide a second pillar for Hungarian local governance.

Local governments are fundamentally attempting to levy as little tax as possible, and they are particularly reluctant to tax local residents. These are natural endeavors. However, local practice and budgetary restrictions mean that within one or two years levying of new local taxes will be unavoidable everywhere. Given that most local governments have introduced business tax, the attempt to keep taxation of entrepreneurs reasonable is another reason to levy residential taxes. Given this, the kind of tax introduced is not an arbitrary matter. This study attempts to introduce a wide circle of options, but it unambiguously supports the introduction of value-based property tax, which can supplement value-based taxes on plots.

Besides discussing a given tax type, a very important part of this study is the methodological assistance it offers local governments hoping to introduce a given form of taxation. The introduction of a tax is seen as a process whose importance extends from initial political decisions to the collection of revenues. The study hopes to provide food for thought concerning questions like: What are the local government's expectations regarding the local tax? What level of revenue is expected from it? Are the residents able to pay? Which form of local taxation is the most equitable? Which tax rates can be used to achieve revenue goals? What exemptions can be employed to ensure that the least well off are not taxed more than they are capable of paying? What are the costs of such exemptions for the local government? How can the local

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government carry this through in political terms, that is to say, how can the tax be presented to the residents? The case of value-based property tax demands consideration of how properties are to be appraised. Given that the introduction of the tax significantly increases the number of taxpayers, the question of how the mass of taxpayers can be handled becomes significant. How can the mass of fairness-based requests and appeals be managed? It is important to make clear that the local government's actions and expenditures are done in the interest of the local populations, therefore the choice is not between taxing and not taxing, but about whether the maintenance of public services—at the cost of raising taxes—is necessary, and whether the community needs publicly financed investments. The populace is already under a large tax burden, but given the demand for certain luxury items, it can be gathered that a significant stratum of society is able to pay a new tax. Of course the number of such people varies from region to region, but based on our analysis we can state that they are in the majority. The affordability of a tax is particularly important, and must be handled through the careful development of a system of exemptions. We believe that an exemption system can be constructed such that it does not endanger tax revenues. We will introduce a simulation which is capable of mapping out expected revenues arising from different combinations of tax rates and exemptions, and how these will affect specific groups in the population. In this way it is possible to calculate how much an exemption system will cost the local government, and how effective it will be.

Studies show that generally richer people live on more valuable properties, hence, an advantage of value-based property tax is that it puts a gradually higher burden on those who can afford it. In the case of special groups, which cannot afford a burden proportionate to their property, local political priorities and programs suited for special conditions must be developed.

An imperative issue for the tax is the determination of the market value of properties. Many legal strategies exist for such, and we suggest a solution which, with some precision, can approximate expected market values, is technically feasible, and, compared to other techniques, is affordable.

While the planning of the new tax is the area of specialized experts, many plans have failed due to the opposition of residents or assemblies. For this reason, local governments must be concerned with making the new tax acceptable, that is to say, with communicating with inside and outside groups. It can be established that the job of making the tax acceptable can be made much easier for the local government if communication is strategically managed before and throughout the introduction of the tax.

As the tax-system requires precise data on the taxpayers and the objects of taxation and constant liaisons with the taxpayers, technical struggles can be a serious problem for local governments, thus necessary technical requirements must be satisfied in advance. Given the significance of the issue, a separate section is dedicated to it.



The study is structured to follow the series of decisions the local government must make if it were to introduce a new tax system. Thus, we will begin by defining what political expectations local governments might have of taxation, then compare different kinds of taxation. From part three on, we deal only with value-based property tax, gathering that we have convinced the reader of the significance of the advantages of this type of taxation. First we study the questions concerning the policy of the tax, that is to say its legal background, the choice of an appraisal technique, the definition of tax rates, and the definition of exemptions. These are summarized in the suggestions for the preparation of the tax ordinance. Then, putting chronological order aside, we closely examine the preparation of the communication strategy, which should be prepared at the same time as those steps mentioned above. The fifth section is concerned with the technical issues of executing the tax ordinance, while in the final section we summarize our observations and recommendations. Some important details are left to be summarized in the Appendix.

I. WHY IS THE RESTRUCTURING OF THE TAX SYSTEM NECESSARY?

The central budgetary subsidy Hungarian local governments have been receiving dropped in real value to two-thirds in the 1991-1998 period. Under such conditions, the maneuvering space of local government has shrunk: they are trying to make operations and the use of resources more efficient, close institutions, or seek new resources. The rate of the decrease of resources can make all three actions necessary at once.

Given that during the period in question local governments obtained properties of significant value, the sale of those properties made up for the deficit. Most of the local governments, however, utilized their privatization revenues primarily for investments and for the payment of credits. The problem is that such one-time revenues do not offer long-term solutions for paying recurrent expenditures. A most dynamic item of local budgets in the 1990s was revenue derived from local taxes, which increased to three times their original volume. Two important phenomena have to be pointed to:

- First, the rate of local taxes could not compensate for the drop in central resources even with the above-mentioned dynamic growth (the decrease of HUF 400 billion as against altogether HUF 70 billion in local revenues).
- Second, the major part of the local revenues (80 percent) come from a type of tax—the business tax—which is disadvantageous from several aspects.

Table 1
The Budget of Hungarian Local Governments for the Period 1991-1998 (HUF billion at 1998 prices)

	1991	1992	1993	1994	1995	1996	1997	1998 plan
Central resources	1,184.1	1,156.0	1,041.9	1,041.9	914.6	813.2	779.6	808.0
Own current revenue	333.7	449.0	446.9	579.7	422.0	481.8	464.1	355.9
of which local tax makes up	36.7	54.4	69.8	73.7	78.1	114.0	115.0	110.0
Credit	18.8	23.7	65.1	92.7	33.2	19.5	20.0	25.0
Balance from previous year	0.0	14.6	23.4	16.7	50.9	49.7	74.0	110.9
<i>Total operation revenues</i>	1,536.6	1,643.3	1,577.3	1,731.0	1,420.7	1,364.2	1,337.7	1,299.8
Operation expenditures	1,172.3	1,201.2	1,213.6	1,222.3	1,063.4	970.0	887.2	920.8
Debt payment	28.3	30.0	34.4	29.3	54.2	45.9	36.8	32.0
Capital and accumulation expenditures	267.0	363.8	328.6	363.4	259.1	263.2	293.6	224.3
<i>Total operation expenditures</i>	1,467.6	1,595.0	1,576.6	1,615.0	1,376.7	1,279.1	1,217.6	1,177.1
<i>CLOSING BALANCE</i>	69.6	48.2	0.7	116.1	44.1	85.1	120.0	122.6

Source: Ministry of Interior, 1999

It is then apparent, that primarily because of economic necessity, the number of local governments collecting local tax grew to 2672 by 1998,² i.e., more than 80 percent of local governments were collecting some form of local tax. Statistics also clearly show that more than 4/5ths of local tax revenue derive from business tax. The most 'popular' form of residential tax is tax on buildings³, and revenues from such tax are one-tenth of those from business tax (see Table 2.). This phenomenon is likely explained by the fact that local governments tax based on the feeling they will receive less resistance from entrepreneurs than residents. This is reinforced by the generally accepted view by which residents are seen as "overtaxed" and "unable to pay more tax." The following section will compare types of taxation in detail. To undertake such an exercise, the following questions must be considered:

- Is the introduction of new taxes necessary for the local government to stabilize its budget or make investments?
- Can the rate of revenue derived from industry tax be raised?
- Is there a need to diversify the local tax system?

² ÖNKORKÉP, March 1999

³ Property tax is characteristically a tax paid by residents, although this is not always the case



- Shouldn't the residents, who demand the maintenance of the level of services, pay for such expenditures in a more direct manner?

Before a local government decides to introduce a new type of tax and decides on the co-ordination of the taxes introduced in the course of the years, it must seriously consider some issues important from the aspects of local policy: how much revenue does the settlement need to maintain local services at a rational level? Who should pay local taxes, which social strata should be burdened and to what extent? What effect do local taxes have on local employment conditions, etc.? The industrial tax, but especially the communal tax on entrepreneurs, does not simply tax a group of "wealthier" citizens, but also makes employment and local production more expensive, and lowers the competitiveness of local products. It is also important to consider the fact that in the end every tax is paid by the population, i.e., and the end user. The possible advantage of direct taxes paid by the citizens is that the local government levying it can realize priorities through tax exemptions and through the taxation system. Experiences from surveying residents⁴ support the results of theoretical work, whereby residents paying local tax follow local government activity (they are more informed, and, for example, they attend assembly meetings more often) more closely.

Every type of tax has positive and negative effects. Local governments must assess them and build such considerations into their decisions.

Table 2
Local Taxes Collected by Hungarian Local Governments, 1998

Tax type	Number of local Governments	Tax Revenue	
		Amount (billion HUF)	Proportion (percent)
Property tax			
– Housing	215		
– Non-housing	633	13,522*	10.0*
Plot	388	1,958	1.5
Communal tax			
– Private	1,525	2,443	1.8
– Corporate	825	1,161	0.9
Tourism tax	482	2,115	1.6
Business tax	2,527	113,652	84.3
Total	2,672	134,851	100.0

Note: * The two types of taxes on structures taken together

Source: Őn Kor Kép (March 1999)

⁴ We will make several references in this paper to a survey which in part forms the basis for the simulation of the introduction of taxes. This survey took place in April of 1999, with representative samples of 400 residents of each of the following cities: Nagykanizsa, Tatabánya, Szolnok, Püspökladány, Szentés, and Orosháza.

II. THE ADVANTAGES OF THE VALUE-BASED PROPERTY TAX

After a local government has decided that it has to transform its taxation system, it shall select—after considering the advantages and disadvantages of the various alternatives—the type (or types) of tax (or taxes) it wants to introduce, eliminate, or modify. Act C of 1990 regulates the types of taxes Hungarian local governments can introduce. In this section we sum up the advantages and disadvantages of the types of taxes permitted by law, and as the subject of this paper is primarily value-based property tax, we will compare the other types of taxes with this one. During the comparison we primarily relied on the consideration scheme prepared by Hernando Garzon (1999), i.e., we looked at whether the tax would really be paid by those who make use of public services, whether the tax base is wide enough (i.e., many taxpayers pay little tax or too few taxpayers pay too much tax). At this point we need to stress that taxing the community is not a crime, since local governments and the population have a choice between more public services and a high tax, or conversely scaled-down public services and lower tax. During the comparison we look at the mobile and immobile nature of the tax base for the individual tax types, the transparency of the tax type, the income capacity of the particular tax type, the stability and dynamic of the tax revenues, the effect of the tax on certain social groups, and fairness and affordability. During the comparison of the tax types, consideration must be given to their distorting impacts on the economy, the exportability of the tax (i.e., whether the local government taxes are paid by the local community or not), the management of tax administration and last, but not least, the political risks of the tax.

Evaluating the Types of Taxes Local Governments Are Authorized to Introduce

Local Business Tax

One alternative to be considered is the local business tax, which has already been introduced by the majority of local governments as shown in Table 2. In 1998 this type of tax constituted 84 percent of the local tax revenue of local governments. What are the reasons for the popularity of the business tax? The advantages of the business tax can be summed up as follows:

- Its administration is easy
- Its pays significant revenue to the local government
- It is easy to make it politically acceptable, as it does not affect the citizens directly



At the same time the local business tax has some disadvantages and shortcomings which cannot be ignored by local governments, and which cause one to suggest that business tax should not be the sole component of local taxation policy. The disadvantages are as follows:

- It is inequitable (net sales revenues are taxed as opposed to profit, this way unprofitable industries pay proportionally more tax than companies in very profitable industries).
- It causes competition among local governments (mobile tax base).
- It leads to economic distortion, because it interferes with the price system (this effect appears mostly on a national level).
- Despite its appearance, it is also paid by the citizens (although it is uncertain that it is paid by local citizens, as the tax may be ‘exported’), so it is self-defeating to believe that it would allow local governments to spare the residents.

Tourist Tax

The law permits local governments to levy tax on tourist operations conducted in its territory, but this type of tax offers a real alternative only to a very limited number of local governments, so we will not discuss it in great detail. The two options available by law, taxation as per guest nights or accommodation fee, have advantages and disadvantages similar to those of the business tax, while the advantages and disadvantages of the version whereby tax is levied on the basis of floor space are identical to those of property tax. In addition, a very important advantage is that the central government contributes HUF 2 for every Forint of tax collected by the local government and therefore, wherever possible, it is desirable for local government to build this tax type into the local tax structure.

Communal Tax

The communal tax on entrepreneurs. The law permits the levying of two types of communal tax for local governments. The communal tax on entrepreneurs taxes based on the statistically corrected size of staff of locally registered companies; in other words it taxes employment. This type of tax should unambiguously be rejected, as along with its many disadvantages, its very small number of advantages are available through the business tax, so in this case the latter taxation form should be given preference. The introduction of both types together reduces the transparency of the taxation system. Let us consider the disadvantages. As it taxes employment, it gives incentive to black-market employment. Moreover, even remaining within the framework

of law, it motivates the higher exploitation of labor, which can cause a higher unemployment rate, which is quite undesirable in the current social situation. Compare this to, for instance, the property tax, which induces a more efficient use of properties, and can thus contribute to the animation of the real estate market. As mentioned above, the communal tax on entrepreneurs competes with the industry tax, but is more difficult to administer. The two combined result in a less clear taxation system, while the revenue gained from it is in most cases more limited.

Communal tax on private persons. Should the local government be willing to tax residents, then the easiest type of tax to introduce is the communal tax on private persons. The advantage is that, as with all residential taxes, the number of taxed subjects being high, the local government can earn adequate revenue even when the tax burden per resident is low. It is easy to levy and administer and communicate, as its name describes the objective, namely that it is collected for communal purposes. However, in terms of carrying the public burden, this type of taxation is the most inequitable, as the same sum of tax is to be paid by all families regardless of their wealth and property, as opposed to the market value-based property tax, which differentiates on the basis of the size of property. The communal tax on private persons also has limited communication advantages, as the number of communal projects which would affect the town as a whole is usually limited—the larger the given settlement the truer is this statement. An even bigger problem is that the preservation of the real value of the revenue requires annual revision of the tax rate. An advantage of value-based property tax is that its various technical approaches make it possible to systematically and automatically re-appraise, which, when the tax base expands, results in the maintenance of the real-value of revenues.

Tax on Plots

More differentiated taxation is possible in the form of a tax on plots, which can be levied both on the basis of size and corrected market value. But from the revenue aspect it is more limited than property tax, and as its advantages and disadvantages are almost the same as for the two types of property tax, we will not discuss them here in details. We only wish to note that wherever the potential income makes its introduction sensible, it can effectively supplement the property tax. The two taken together can be viewed as property tax.

Property Tax

There are many economic arguments, which can be quoted in favor of the property tax, thus it is not by accident that in international practice this is the type of tax which has become decisive for the financing of local governments. What, then, are the advantages leading to this situation? Some advantages are independent of the method of levying this type of tax, namely, whether it is levied on the basis of floor space or market value. What are these advantages? Property tax represents revenue that is



significant, stable and easy to plan, and the primary reason for that is that it affects the entire population, so it utilizes a tax base wide enough to enable the local government earn sufficient revenue even when burdening the residents to a limited extent. The tax base is difficult to hide and is immobile, e.g., even if somebody moves away from the town the property will stay and the new owner will continue to pay the tax. It is an optimum type of tax on the level of the national economy also, because it cannot be exported, so the services of the local government are financed only by the citizens living in the area of the local government. Because of these advantages it is a transparent, clear form of taxation. Naturally, it can be levied not only on private persons but also on entrepreneurs, in which case it acts as motivation for a more efficient utilization of property, and, as one can assume that wealth correlates more closely with profit than with turnover, it can supplement industry tax. Moreover, as it is not an indirect tax, it cannot be built directly into prices, thus it leads to lower economic distortion than does business tax.

Property tax levied on the size of floor space. The concept of property tax is not unfamiliar to Hungary, as out of the six local governments we studied, four had already introduced it. Viewed nationally, the local governments which already levied this type of tax levied it on the basis of size of useful floor space (with two exceptions). What made them select this method? It is technically easier, as it is much simpler to establish the floor space of a flat (although residents most often mix up the floor space of the houses with the useful residential space) than its market value. At the same time most of the local governments realized the disadvantage of this type of levying, namely that it is much more inequitable than taxing on value basis. Moreover, the revenue can be retained at real value only with political risks. What exactly does this mean? Fairness can be approached in different ways. If we view fairness in such a way that we feel those that use services are the ones that should pay tax, then the literature shows that there is a tighter relationship between the value of properties and services used than between the size of properties and services used. If fairness is seen in such a way that similarly situated groups should bear similar burdens, while differing groups should bear differing burdens, then tax levied on the basis of floor space is unfair, as larger properties are not necessarily more valuable and it can easily happen that with this type of tax the local government taxes large families rather than the wealthy. Most local governments levied the tax at a very low rate primarily because of the unfair character of the tax, and to spare poorer families the local governments could not raise the tax rate any higher. Although the HUF 900/m² rate permitted by law would give the local governments significant revenue capacity, in practice the local governments can tax only at a fraction of the maximum rate. Retaining the real value of tax revenue is possible only through an annual increase of tax rates, which entails annual political debates in the local assembly. These are the defects, which make it necessary for a significant portion of local governments to investigate the ways and means for switching over to a market value-based taxation of buildings.

Property tax on the basis of corrected market value. In Hungary today only two local governments—Nyíregyháza and Németskör—apply the corrected market value for determining the bases of property tax, while several other local governments are considering its introduction. The intention is strong but the local governments are stuck when it comes to implementation. What is the cause of this? All local governments realize that tax on buildings is fairer when it is a value-based tax as opposed to a tax on floor size, and in this case this type of tax more closely resembles classical wealth tax. Politically, it is also easier to defend: those whose property is more valuable, that is wealthier people, pay more. It also provides an optimum source of revenue for the local government because with change in market value the tax revenue also changes, and in an inflation environment that mostly means increases without the need to adapt the tax ordinance annually to the expenditures as they increase with inflation. Currently, as the country is on the threshold of accession to the EU—whereby one can expect an increase in the real value of flats—this source of revenue can result in income for the local governments which dynamically outgrows inflation. At the same time, this type of tax has not been implemented as yet because its introduction is technically difficult due to the need to appraise the properties and to avoid masses of appeals. Further, many local governments believe that the residents better understand the concept of tax on the basis of floor space than the one on the basis of value, and thus accept it more easily. Some local government even doubt whether wealthier people live in more valuable properties, and they do not know how to manage this problem. We will now present arguments which serve to remove doubt by presenting a simulation analysis of the social effects of the two building tax types, and by presenting relevant communication strategies, necessary evaluation techniques, and a review of administrative problems.

Arguments in Favor of the Market Value-Based Tax on Buildings

It can be gathered that when contemplating the introduction of a new type of tax, the local government selects the new type of tax to be levied after considering the advantages and disadvantages of the alternatives. When comparing advantages and disadvantages, we found that among all types of taxes, the property tax based on value has the most favorable features, as seen in Table 3.

Table 3
Features of the Ideal Tax System

Features	Tax type Tax base	Business Tax	Tourist Tax m ² Turnover	Communal Tax Corp.	Residential	Property Tax Floor Space	Value
Those who use services should pay for them			☆		☆	☆	☆
The tax base should be stable			☆		☆	☆	☆
The tax system should be transparent		☆	☆	☆	☆	☆	☆
It should generate sufficient revenue		☆				☆	☆



Features	Tax type	Business Tax		Tourist Tax		Communal Tax		Property Tax	
	Tax base			m ²	Turnover	Corp.	Residential	Floor Space	Value
It should be equitable and affordable		☆			☆				☆
It should cause the lowest possible economic distortion			☆			☆	☆	☆	☆
It should not be possible to impose tax on citizens who are not part of the local community						☆	☆	☆	☆
Administration should be easy		☆	☆						?
It should be politically acceptable		☆			☆		☆	☆	☆
The tax base should be wide and the tax rate should low		☆					☆	☆	☆

As discussed above and as seen in the table, only the business tax offers significant revenue capacity comparable to the property tax types, but that is mostly true only in the industrially advanced areas of the country. But due to some of its characteristics, one could not recommend it as a single source of revenue even in those advanced areas. In most settlements the introduction of tourist tax and tax on plots is rejected because of small revenue capacity, but wherever they can be introduced in a rational fashion, they can be recommended as supplementary elements in the tax system. The application of communal types of taxes is not justified because of the many problems they entail and because local governments have much better alternatives compared to these two types of taxes.

When selecting one of the two types of property taxes, several factors need to be considered. One is revenue capacity, a second is equity/fairness considerations, and a third is technical feasibility.

Both types of taxes can produce the necessary revenue capacity for local governments. Further, as emphasized above, the revenues derived from the value-based building tax grow together with inflation in most cases, while in the case of property tax levied on the basis of floor size, the real value of revenues drops. Hence, given its dynamic nature, the tax levied on value basis is much more advantageous.

The biggest argument for the tax levied on the basis of value, compared with floor space-based tax, is equity.

Table 4
Comparing Tax Levied on the Basis of Floor Space with the Tax Charged on the Basis of Property Value

		Type of Property Tax	
		Area	Value
Revenue		90.0 M. HUF	89.6 M. HUF
Tax rate		200 HUF/ m ²	1.25%
Percent of Total Tax			
Percent of total tax paid by households	Lower status households (37.7% of households)	32.6%	28.5%
	Upper status households (24.6% of households)	29.4%	35.0%

Notes:

1. Lower- and upper-status households are represented by the lowest and highest quintiles.
2. The table shows the effect of taxes based on floor space and on market value for one concrete city, Püspökladány.

We performed a simple simulation, comparing an area-based and value-based property tax yielding the same total revenue (see Table 4). For Püspökladány, tax levied on the basis of floor space resulted in taxing the poorer strata of the population more heavily than was the case for value-based taxation. Given that the relationship between property value and income is closer than that between floor space and income, the wealthier citizens pay a greater portion of the tax with a value-based tax. That also answers the concern that the local government can collect bigger revenue on the basis of floor space only by making the poorer residents pay.

Thus it has been shown that value-based property tax is capable of providing stable revenue for the local government while being fairer (compared to other taxation types) to the residents. The remaining question is, can the technical problems local governments must face when levying tax on the basis of value be overcome? Can the local government develop an appraisal procedure, the technical requirements of which do not surpass the resources of the local government, and which meets legal and practical requirements? This is the concern of the remainder of this study. But to begin, let us clearly state that the authors of the study believe that after careful and considerate preparations, local governments can overcome technical difficulties and can establish a proper system of taxation on the basis of property value, in conformity with social policy preferences.

III. TAX POLICY

The tax policy of the local government must be part of the strategic program with which the leadership of the town manages the settlement. It is within the frameworks of



this program that the town must define its expected annual revenues, and determine how it will cover expected expenditures. The introduction of a new tax, or the transformation of the existing tax system, must be treated as a strategic decision which local leaders can properly execute in a period of one to two years.

Depending on the aims associated with the introduction of a new tax, priorities will differ. Should the tax be an attempt to make up for the budget deficit, then revenue provisions will be the first priority, but even in this case the local government will need to decide which social groups will be burdened with the new tax, and at what rates. Should the tax be an attempt to finance a new service, or an old one at a better level, then beyond revenue aspects, it will be important to establish which social groups will be most burdened by the new tax, because a key point in the local government will be the demand that the tax should be paid by those who are using the service. Should the new tax be the replacement of an earlier local tax, then expected areas of improvement should be made clear. Whatever the motivation of the local government, the definition of decision criteria, which will characterize the choices in planning the new tax (e.g., various tax rate-exemption combinations), is unavoidable.

As is the case with all major decisions to be taken by the local government, the introduction of a new type of local tax demands professional preparation. Such professional preparation must take place in concert with political preparation, i.e., within a specific period of political preparation. A key element of professional preparation is the simulation of the expected effect of the local tax. The local government intending to introduce a local tax must be prepared in advance for the revenue expected from the new tax, and must estimate the burden the local tax will bring to the local staff (e.g., due to the increase in the number of taxpayers) so future corrections may be kept to a minimum. A well-prepared simulation model can answer questions such as: what will be the effect of various types of tax exemptions on various social groups and what revenue decrease will it bring to the local government? How will the local tax will effect various groups of residents? And how willing will citizens be to pay? The simulation study also gives an opportunity to define higher tax rates which will compensate for the decreased revenue deriving from the introduction of planned exemptions, and to analyze the social effects of the new tax.

All in all, the following steps need to proceed the administrative phase of the introduction of the tax:

- Policy decision on the principle to introduce the tax, to transform the taxation system.
- The identification of basic expectations (the volume of revenue) and other desired effects, and effects to be avoided (e.g., bearable burden on the

citizens, affordability issues, moving away from the town, the development of certain districts).

- The design of the new tax (tax rates, exemptions, and appraisal technology).
- Preparation of, and, if necessary, the beginning of, dialogue with key groups (local politicians, office staff, citizens, perhaps also entrepreneurs) and their representative organizations (civic organizations, chambers) on the introduction of the new tax.
- The passing of the local ordinance and the launching of the administrative procedure in conformity with the ordinance.

This means that in the second phase of preparation the local government must identify legal alternatives, variations on tax that are most appropriate given local conditions, make simple calculations (e.g., on statistical data, see the section entitled “Data Registration Techniques” in the Appendix), and estimate expected revenue. In the third phase more complex techniques (residential survey, property assessment; see “Data Registration Techniques” in the Appendix) are used to refine expectations of the new tax and tax system. A tax planned in such a way can be presented in community and political forums. Local governments, which prepare for the introduction of the tax in such a way, can confidently enter negotiations, as the effects of all counter-proposals can be checked and presented.

This remainder of this study makes the assumption that the reader has been convinced, by the arguments, of the advantages of the value-based property tax. This tax is the subject of the rest of the paper.

The Tax Base

Should the political leadership of the local government decide in favor of value-based property tax, as this meets all the requirements demanded of the new tax, the appraisal of properties must be executed. First, some legal conditions and limits pertaining to taxation must be examined.

The Legal Conditions and Limits of Property Tax

One of the most important questions of interest for local governments when introducing a new tax is the income they can gain from the possible types of taxes. Legislation sets strict limits for local governments in designing their taxes. Housing and non-housing properties can both be taxed, but the range of central exemptions provided by law is wide, and they are to be considered when the tax is designed. Thus, the city must take into account that fact the following properties cannot be taxed: temporary



lodgings below standard; the properties of social, health care, child care, teaching, and education institutions; the properties of budgetary organs; properties of organizations supplying public services; those of churches; the supplementary premises of dwellings; and agricultural storage facilities in general. The designing of tax revenue is also affected by the fact that the law permits taxation on the corrected market value, i.e., 50 percent of the actual value of the property. Another limitation while planning, which must be considered by the local government, is that the exemption from the effect of the pre-1990 property tax will remain in force until the expiration of the law. Today, in some towns, that exemption applies to 30 to 50 percent of properties.

Although at first glance the law appears to set serious restrictions, simulation calculations show that the possibilities for local governments are still quite numerous: the tax ensures significant revenue potential, and there is ample space for the attainment of local priorities.

The Market Value of the Properties

Options for appraisal methodologies. The success of the value-based property tax will depend on the exact and acceptable appraisal of the value of the property. All properties have value, and current Hungarian practice shows that owners are aware of this fact. It should be noted, however, that property owners are interested in establishing low property values for tax base, which can cause problems. Internationally used appraisal techniques are discussed in detail in the section of the Appendix entitled “The Determination of Property Values.”

A most accessible solution for appraising property value is self-appraisal by citizens. But this approach makes some generally applicable control technique necessary. The real problem is that when using the self-appraisal technique, the equity of property tax can be distorted, as people with like-valued properties may end up paying different levels of tax. In the long run this technique can lead to the erosion of the real value of the local government’s revenues, as property owners, when submitting their appraisals, will naturally not calculate for increases in value. However, in smaller settlements (with maximum populations of a few thousand) this technique can be a stable solution, because the special environment can dampen the drawbacks, and areas where this is the best method become particularly important. Due to personal contacts in these settlements, self-appraisal is less distorted than in impersonal large cities. As a consequence this method can replace all other methods (which in these cases are difficult or impossible to execute) in such environments, where capacities of local governments are significantly limited.

Perhaps an even simpler solution is to divide the settlement into zones, and within the zones levy the tax on the basis of floor space. The advantages of this solution are to be found in the simplified differentiation among properties, but it does not entail

any of the advantages of value-based tax. It may be a temporary solution for smaller settlements (with populations lower than 50,000).

Should the approach of asking owners to evaluate their own properties not be chosen, and instead, should the local government decide to define property values itself, appraisal can be provided in two ways: individual appraisal with the help of real estate experts, or through 'mass appraisal,' in which an equation and key data regarding the average property values and key characteristics are used to calculate value. The first solution requires the availability of a significant expert base and continuous training, while the legal background for second solution is underdeveloped, which can cause some problems in execution. The appraisal technique must be chosen with care, and security measures, which defend the local government from mass suits, must be built into the system.

We believe that the value-based property tax levied by determining value on the basis of some market value formula eliminates the need for a significant increase in the size of taxation staff while considering estimated market value, and results in appraisals which would prevent an uncontrollable number of appeals and lost cases of litigation. Such a tax type can be an important step in local taxation in Hungary after the change of the political/economic system. The essence of the system is simple: the average specific housing value of the settlement should be corrected on the basis of the key features of the flats (number of rooms, age, geographic position, etc.). The introduction of mass appraisal requires a detailed database, the construction of which is expensive, but the cost of which is justified by the savings in terms of financial and political costs. The idea of favoring a formula-based methodology is shared by many of those in government circles now working on the development of a feasible value-based property tax. Introducing the tax in this manner is largely dependent on the caution and preparedness of the local government.

Of course an important factor in choosing an assessment method is to reduce the number of appeals. The method used to appraise properties, just like the commercial values ascribed to the properties, will influence the number of appeals. Those taxpayers wishing to fully appeal and defend their views in court are confronted with considerable expenses. As a consequence, the taxpayer will only do this if they can avoid or dramatically reduce their tax payment. If in establishing the tax base the local government makes a conservative estimate of the market value of the property, it will ascribe value in the lower range of possible sale prices for the property reduce the incentive for taxpayer appeals. The value estimates of the local government, which are the foundation of the tax, must ensure that the ascribed value be acceptable to those concerned. The value estimation meets this criterion best when it is near the lower boundary of market value, and when the use of universal standards are ensured for all. Property values arrived at through formulas are advantageous in these terms. Making the formula public allows residents to review value estimates themselves.



The likelihood of appeals regarding valuation can also be reduced if the local governments used a different methodology in which properties are assigned to various value bands for tax purposes (for more details, see Appendix 1.8). In certain cases (at the top and middle of the bands) this method decreases the risk, but makes appeal more likely at the bottom of the bands. Should appraisal be based on simple expert calculations⁵ (this is a simpler method than using a formula), the method will make up for the real appraisal. Tax appraised in this way is similar to the English model. As far as types are concerned, the band method falls somewhere between floor-space-based and value based (band-free) taxation. An advantage is that it makes annual corrections simple, although it distorts the relationship between the value of properties and the level of taxation. Another problem is that this method of setting tax is currently not properly legislated, though the law does not disallow it.. With this method, should the local government under take it, the definition of rates and brackets, i.e., the appraisal technique itself, will be a political decision. The advantages and disadvantages of the techniques are summarized in Table 5.

Table 5
Comparing Appraisal Techniques

Appraisal technique	Advantages	Disadvantages
Self-appraisal	Inexpensive; no appeals	Inequitable; expensive to verify; tendency to underestimate; unstable tax base
Expert appraisal	Realistic value	Expensive to establish and maintain; subjective (each expert will give a different value); encourages appeals
Floor-space differentiated by area within the city	Inexpensive; no appeals	Different from real value; inequitable; leads to segregation; annual political decision; defining areas will be a political (not a professional) decision
Appraisal using bands	Inexpensive; lowers number of appeals	Different from real value; inequitable; legality uncertain; all in lowest band may appeal; defining bands will be a political (not a professional) decision
Calculated value	Realistic value; objective; value-modification is inexpensive; lowers number of appeals; lowers chances of successful appeals	Relatively high introduction costs (database) Does not eliminate appeals

⁵ Appraisal in this case consists of collecting data on the properties, and then placing the properties in the appropriate bands.

While the utilization of calculated assessment maintains property value proportions, and can be done with relatively few resources, the introduction of a new tax cannot be undertaken without distorting tax equity or without increasing administrative capacity. Hence, the success of a value-based property tax depends to a large degree on the possibility to use calculated value within current Hungarian conditions. Can such a technique be harmonized with current legal regulations, which only acknowledge the term “commercial value”? What type of tax can be introduced in the current legal environment?

Current legislation on methods for determining “market value”. As is known, the regulation of local tax is defined in Law 1990 C. In the case of levying tax based on property value, the law on local taxes refers to the Law 1990 XCIII on tax charges, which defines the concept of commercial value (some important elements of this latter law are quoted in the Appendix, under the section entitled “Regulation of Assessment”). According to article 16.β b) of Act C. of 1990 regarding local taxes, the basis of the property tax (if levied on the basis of value) is 3 percent of the corrected market value.⁶ In the interpretative provisions of the act, corrected market value, established by employing the provisions of the act on levies, is 50 percent of the market value.⁷

The laws and regulations specify not the techniques for property appraisal, but the requirement of providing realistic valuation (see “Regulation of Assessment” in Appendix). Therefore it is possible to assess the value of properties without a site inspection, based on the data of the property. It is necessarily so because (in contrast with the cases falling in the scope of the Act on Duties and Levies, when the value of property must be established in some cases) in the case of the tax, subject to the exact conditions of the tax imposed, the majority of the properties of the settlement must be appraised. Unfortunately property appraisal for value-based property tax also differs: the 1990/C law refers properties which are under the auspices of the tax charge law, and as these properties have not necessarily been on the market, their market value can be established only through indirect means. Another problem with the above-mentioned conditions is that it ties long-term commercial value to the sale price established at one particular moment. Given this, the law on levies uses the expression “generally attainable price” when defining the term.⁸

The law does not contain an explicit description of appraisal technique to be used, and only defines conditions regarding the received value. Therefore, current legal

⁶ 1990. C. tv.16.§ b)

⁷ 1990 C. tv. 52.§ point 13

⁸ 1990 XCII. tv. 102.§



regulation does not present an obstacle to the use of calculated value, although it clearly does not support its use either.

Method recommended for the definition of value of properties. The method recommended for the establishment of the value of properties is a linear equation which can be applied to all properties of the settlement with a standard procedure.

Table 6
The Establishment of Property Value

$$Pr\,opertyValue = AverageValue + T_1 * Sz_1 + T_2 * Sz_2 + ... + T_n * Sz_n$$

where: T 1 to n are the factors defining the value of property

Sz 1 to n is the multiplication factor which defines how the given factor affects the property value.

The calculation of the equation is based on a measurement of a representative sample of the city's properties. The database on the properties in the sample contains all the relevant physical parameters of the properties and the property value estimates of one (or more) real estate expert(s). It is practical to calculate the formula with a multi-variable regression. This procedure ensures that the property values calculated on the basis of the formula will actually be close to the value that can be acquired for the given property in the market. It is recommended that an appraisal expert be employed to generate the formula and identify relevant parameters. Another factor in the choice of indicators is that they should be easy to verify.

On the basis of the market prices for properties, the local government can establish a specific average price for the community (for a square meter of floor area) and then it can define correction factors for it (e.g., zone of the property, status, infrastructure access, etc.) and then multiply it by the received individual figure with the useful floor area of the property.⁹ The advantage of the latter procedure is that it is more transparent, which makes it more acceptable and is actually close to the real market value, which is calculated in a very similar way. An important issue is how the local government is to calculate the condition of structures and the effect of renovations into the price.

It is easy to see that the use of such a formula can make annual re-appraisal simpler, as the only variable which needs to be changed is the average commercial

⁹ The choice of unit of floor space is not important if the same floor space is used in multiplication as in the calculation of price category when constructing the sample. As the tax serves the residents, we recommend the use of net space, because this is the most well-known value among residents, and the Land Office uses this number as well, making the verification of data simple.

value for the city. In the case of annual appraisals those changes which may effect the value of properties (e.g., renovations) must be noted. We recommend, however, the review of the other factors in the equation every five years. This is necessary because the structure of property values and conditions in the city can change (e.g., some neighborhoods may increase in value). Despite its ability to follow changes in property value (which is one of the great advantages of this approach), it is not advantageous to fully build possible radical changes in property value into the system. Avoidance of such unevenness can be helped by incorporating data from more than one year in the calculation of commercial value, i.e., to use data averaged over five years.¹⁰

In order to generate and use the formula, a database must be obtained or developed in which the calculations can be completed. According to our current knowledge, this database could be the more or less up-to-date sale and purchase database containing the data registered in Land Offices, or can also be a database containing data compiled from forms filled in by the taxpayers. In the former case the procedure involves less, but more reliable data, but it is definitely required that the taxpayers should provide the data for their own property. Even in the latter case, an attempt should be made to request data which can be controlled with a relatively simple procedure. Collection of data from the Land Registry Office or the Duty Office by the local government cannot be avoided even in the second case. (The methods for constructing the database are discussed in the Appendix, in the section entitled "Data Registration Techniques") Currently, local governments cannot be certain that they will have automatic and free access to the above-mentioned data on property registry and property transactions. Practice shows that local governments can get the information when they need it, but legal modifications should be made in this area.

Access to data within the Mayor's Office must also be improved, given that often the technical department has property-related data and information, which from the tax viewpoint is important. Such information is necessary for orientation and approving changes. Thus, the task of making information more accessible (hopefully on-line) is both a national and a local one.

Tax Revenue Potential

After the most important questions concerning the introduction of the tax (expectations of the new tax, legal conditions, property assessment; see Section III on the administrative phases of the introduction of the tax) have been settled by the local government, and the outlines of the new tax are in place, the following question must be asked: is the revenue adequate, on how much revenue can the local government depend from the new tax? The local government at this point has its initial political

¹⁰ This latter solution is worrisome in terms of current legal regulations, as it refers to actual value. A more understandable, but not always usable solution, in cases where property value is subject to quick change, is for the local government to increase the frequency of re-appraisals for the given period.



objectives regarding the introduction of new taxes or the modification of existing ones, and is clear on how much revenue it requires, which social groups it hopes to tax and which it hopes to exempt, and knows what burdens it deems allowable, and will now enter a new phase. With the use of a simulation model it must test its expectations and then work out the final parameters of the tax (tax rates, exemptions) in conformity with its expectations.

Table 7
The Maximum Legal Revenue from Property Tax

	Estimated tax revenue* on market value basis rate of 3 percent (Billion HUF)	All introduced local taxes	
		Revenue 1998 (planned)**	Percentage of total revenue
Szolnok	1,356.3	1,050.0	10.9
Szentes	570.7	270.0	9.2
Püspökladány	215.2	43.5	4.9
Orosháza	574.2	517.0	12.2
Nagykanizsa	967.7	561.6*	7.8
Tatabánya	756.9	420.0	5.9

Notes:

* The data presented in the table is based on revenue from structure tax for homes only. It does not include revenue from taxes on commercial property.

** In the case of Nagykanizsa data is from 1997

When defining potential tax revenue, two types of limitations must be taken into account. The first is legal limitations, while the second is the ability of the residents to pay. The legal restriction amounts to the maximum rate according to which local tax ordinances can levy taxes. The ability of the residents to pay is as much a physical limitation to the tax as are the legal limitations. Further, it is very difficult to establish. In order that the local government should not unnecessarily reduce its revenue, but at the same time that its taxes be defined at a collectable rate, a preliminary impact analysis and a developed and sustained system of equity-based exemptions are necessary. The impact analysis can help define the average level at which the residents of the city and various groups within the city can afford to pay the tax. Equity-based exemptions assist in individual and unique cases. We discuss impact analysis studies, which are still rare in current local government practice, below.

Table 7 shows that value-based property tax levied on homes at the highest rate (the law allows this rate to be 3 percent of the corrected commercial value, i.e., 1.5 percent of commercial value) results in higher revenue than that planned for 1998 from

all local taxes, and for all the cities in the study.¹¹ Taxes on corporate properties add to this revenue amount. Thus, it would seem that property tax can result in adequate level of revenue for those local governments which utilize it.

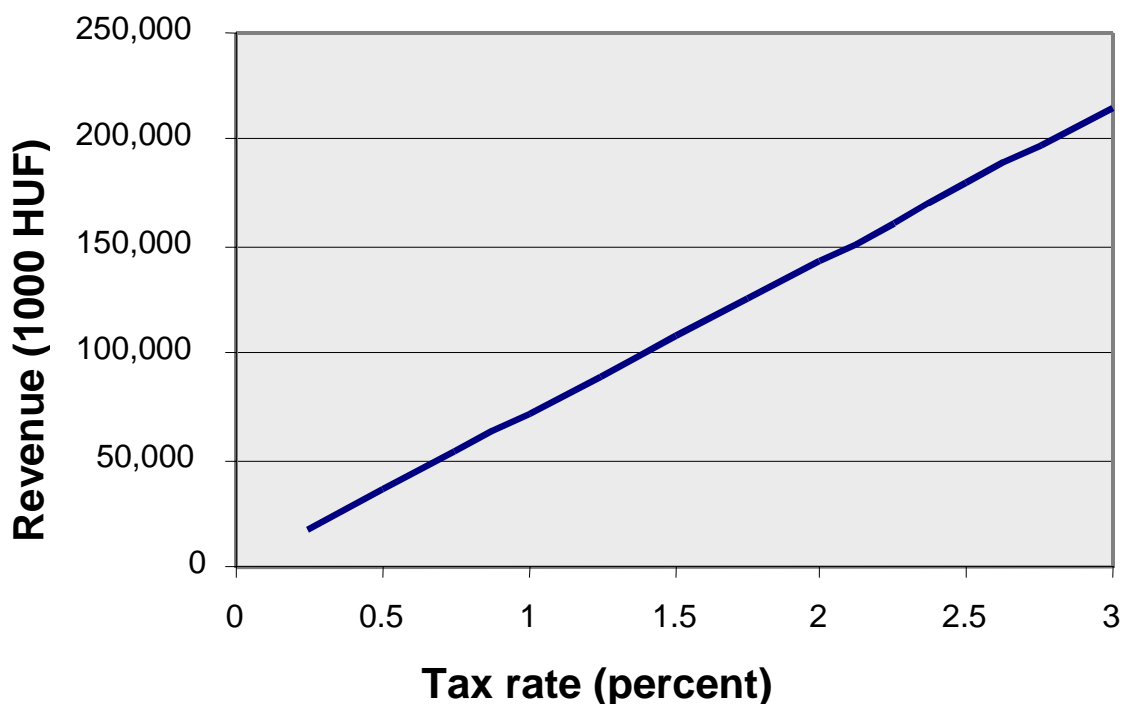
As the property tax has such a high revenue potential—within the framework of legal regulations it allows for local governments to gain significant revenue—it gives local governments a great deal of freedom in establishing tax rates. Two points must be kept in mind. First, the revenues must reach the level defined by the local government. Second, as already noted, rates cannot be such that the residents cannot bear them. Political risks concerning the tax must be minimized. The choice of an appropriate tax rate system is not only a technical matter, but, as discussed above, a political one as well. For the tax to be truly affordable, real social considerations must be addressed by including an exemption system, and such a system is a factor when choosing rates. Thus, it is a good idea to conduct a simulation exercise, before introducing the local tax, which shows results of the combination of various rate and exemption schemes, such that at the end of the process, the revenue from the tax meets all expectations.

Graph 1 illustrates what tax rate a city the size of Püspöladány must use in order to reach a given expected revenue. It can be seen that the revenue of 90 million HUF used in the study can be attained using a rate of 1.25 percent. The level of tax exemptions will modify this.

¹¹ Taxes levied at the maximum rate, as in Table 7, belong to the realm of theory, as the rate may imply a burden on the residents that would bring political risks that no local government would be willing to take. It can be seen that the property tax levied on the basis of market value is very sensitive to the value of the properties in the given settlement, so it can bring a lower volume of revenue for local governments operating in economically underdeveloped, crisis-stricken areas of the country. Accordingly, we have to separate the immediate effects from the long term effects of such revenue.



Graph 1
Revenue from Property Tax Utilizing Various Tax Rates



Note: The graph shows estimated revenue on taxes collected on homes in Püspökladány.

Before we discuss the effects of exemptions, let us consider the development of property tax revenues through consistent conditions over time.

The Dynamic of Tax Revenues

The question of how revenues will change over time is crucial for the new type of tax. While local government expenditures follow price increases, resources rarely change in this automatic way.

The tax base of value-based property tax can increase for two reasons. First, the number of taxable homes may increase. Second, the value of properties may increase. The growth of quantity can derive from construction of homes, expansions, and from the gradual phasing out of the exemptions from home tax (a situation unique to Hungary). Tax base can expand through the growth in the value of properties when the local government periodically (yearly) re-appraises properties.

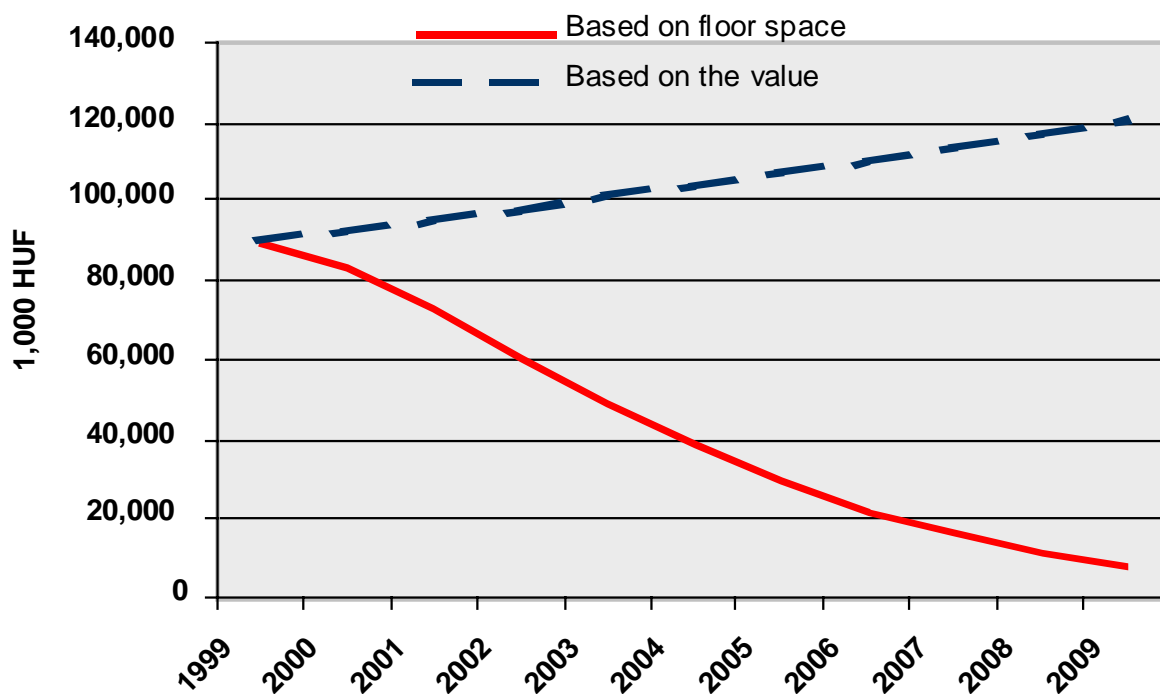
While the net growth of the number of buildings is generally slow and constant¹², the growth of the value of properties is far less predictable. Among other things, it depends on general changes in prices, the unique economic condition of the city, and the demand for local properties. Although there is no certain relationship between the value of properties and inflation, as property prices can temporarily decline in a nominal way, experience shows that in the long run the two tend to change in the same direction.¹³ There is no automatic relation between the change in value of properties and tax revenue. Practice and experience from abroad, however, show that adjusting and indexing tax rates is a serious difficulty for local governments. This problem should be addressed when choosing the appraisal technique, and should be cleared up and managed when drafting the local tax ordinance. We recommend a solution which does not require an annual political debate, because, again based on experiences from abroad, this leads to the failure to keep up with value-increases.¹⁴ If the local government fails to deal with this problem, the success of the tax is put at risk. Graph 2 shows the projected change in tax revenue in the Püspökladány case, comparing area-based and value-based tax.

¹² Due to the gradual removal of exemptions from the 1974 house-value tax until 2007, in the next few years the tax base can be expected to gradually increase, for which reason the local government using consistent tax rates and depending on the positive effects of reappraisal, can count on new revenues. Further, due to the widening of the circle of taxpayers, the increase is not attained by increasing the burden on taxpayers, i.e., by lowering the acceptability of the tax. For this reason, keeping up-to-date information on house-tax exemptions is an important task of the local government tax office.

¹³ Taking into account the fact that due to the economic crisis of the period the real value of homes dropped 30% from 1992-1997, and further that long-term economic growth has begun, although it may slow down, and further Hungary's upcoming accession to the EU, property prices will converge and we can expect an increase in the real estate prices. The first signs of this were already evident in the first half of 1999

¹⁴ Although housing has lost some 30% of their real value countrywide due to the economic crisis, an increase in property prices is to be expected as economic growth has started and Hungary is joining the EU and prices will converge.

Graph 2
The Dynamic of Tax Revenues in Real Value



Note:

The example shows the case of Püspökladány, presenting the effects of inflation in the case of taxes levied at the rate of HUF 200/m² and 1.25 percent. With the simulation we took the rate of increase in the real value of homes at 3 percent annually and calculated with gradually dropping inflation: 1999 – 8.00 percent; 2000 – 6.00 percent; 2001 – 4.00 percent; 2002 – 3.50 percent; 2003 – 3.00 percent; 2004 – 2.80 percent; 2005 – 2.60 percent; 2006 – 2.50 percent; 2007 – 2.50 percent; 2008 – 2.50 percent

The upgrading of appraisals can be done with several methods. Estimated market value of individual properties can be indexed according to monetary indicators like inflation or the Hungarian bonds index. A more exact method, and one which results in adjustments which better reflect the real value of the property, is to correct appraisals based on the sales data from the previous year, using the average price changes. Another factor to take into consideration is the effect on value of large investments made by the local government.

Automatic indexing will not be a solution for those cases where some extraordinary factor (EU accession, war in a neighboring country) changes property values sharply (even up to 50 percent) in the span of one year. Decreases will have an undesirable effect on the local budget, while increases may cause taxpayer protests. For these cases there are several solutions (post- and pre-corrections), but it is by all means worth preparing for such situations when planning the tax. The local government

can restrict the range of correction, which can be applied to given properties from year to year. For example, if the maximum change is 15 percent, then the correction of the value of the property (supposedly 50 percent) can take place over the span of several years, i.e., it will take at least four years for the appraisal value to match market value. Should prices decrease in the meantime then the process speeds up, and the tax revenues of the local government will be more balanced and less volatile than changes in the market. Another method involves the local government preparing for such situations by using the averaged real estate price changes for the previous five years, instead of the numbers for the previous year, as a basis for index calculations. The effect of the two approaches is similar, although the maximum correction approach is safer.

Naturally these methods can only generally keep appraised property values close to the market value, given that the construction of prices is also subject to change. Various parts of the city, or various segments of the city properties, can have prices change in relation to one another. Hence, it is important to fully re-evaluate and re-appraise properties (changing variables in the formula) with defined regularity (e.g., every five years, or to minimize political risk, every four years, in the second year of the governing cycle). The indexing of all appraisal types is advantageous, because should it not be in place, re-appraisal every four-five years can result in overly high changes in assessed property value and the tax payments of families.

In summary, the introduction of market value-based building taxes provides a substantial income capacity for local governments. Nevertheless, in the planning of revenues the broad spectrum of exemptions stipulated by legislation would have to be taken into account, and local governments cannot disregard factors like the tolerance of citizens and political risks. The preference of the value-based option is justified by the fact that it retains the real value of municipal revenues when proper re-evaluation methods (e.g., indexing) are applied, and thus the political hazards of annual rate increases can be avoided.

Impact Analysis

The goal of impact analysis is the preventative preparation of the local government for the socio-economic effects of the introduction of the planned tax, such that it may plan exemptions that will not distort expected revenue. Impact analysis is the major advantage of simulation based on a survey of citizens. Essentially three important issues deserve closer examination in the framework of the implication analysis:

- What will be the effect of the new tax on distinct groups in society?
- What exemptions can most effectively minimize undesired social effects?



- What revenue decreases accompany given exemptions?
- To what degree will revenue decrease due to the estimated amount of overdue payments?

Types of Exemptions

When planning the tax, local government can provide exemptions for essentially two reasons. The first is to make the tax affordable and to avoid overdue payments, while the second is to conform to various local political priorities. Local government may differentiate among exemption forms depending on the essence of the rationale for the program. Given this, exemptions might be full or partial, might be tied to the attainment of some level (e.g., the sum of the tax cannot exceed 2 percent of household income, but up to this level even the poorest must pay), might be temporary (e.g., for the unemployed), or in theory time-delayed exemptions might be conferred upon single elderly persons or passed on to their heirs.¹⁵

Exemptions based on affordability or fairness. Exemptions aimed at affordability are very important, because for many these serve as a guarantee of the equitable nature of the tax. These exemptions can ensure that the local government does not overtax the residents.

The planning of exemptions, which are based on a measurement of acceptable affordability, is almost as big a problem as the planning of the tax itself. There is a danger that the exemptions, instead of leading to equity, can damage the natural effect of the property tax, which is to tax higher wealth and bring otherwise untaxed incomes into the support of the public burden.

The idea of fairness means exemptions tied to the income situation of taxpayers. However, in recent times income hidden from authorities is about 30 percent, and hidden income is concentrated in certain social strata and professions. Income-based exemptions then in themselves may in some circumstances actually increase inequality. A solution can be to add a wealth test to income-based exemptions, i.e., those whose homes are not worth more than a certain limit value (not too high and not too low, e.g., four-million HUF¹⁶) are eligible for the exemption. This solution can in essence eliminate damage arising from those with high income that do not pay tax, and makes it possible to keep the burdens of those who can least afford them within reasonable limits.

¹⁵ In the West this is referred to as the inheritance tax. In Hungary, current legal regulation does not allow for this institution, although its introduction would be a positive development.

¹⁶ Of course this value can be different, depending on the property values in the city—its determination is a political decision.

There are some simpler options, but these are less effective and less to-the-point. One example is to collect taxes only from those whose prospective tax payments are above a certain level (e.g., 1,000 HUF). A critical group in terms of the property tax is the single and elderly. In the case of low-income pensioners the “inheritance tax” can be a solution, where the heirs pay the tax later on. However, this method requires changes to existing laws.

Exemptions based on local political priorities. The sphere of exemptions which a local government can draft when introducing a new tax is virtually boundless. Specific family policy or urban policy areas can be served as easily as general exemptions can be incorporated. When introducing such exemptions, the local government must take two important points into consideration. First, can originally planned revenue be kept after introducing the exemptions? Second, how effectively can the desired positive effect of the exemption be ensured? As such, exemptions based on the number of children in the family will not serve social purposes, but will likely serve family-policy purposes. The local government, when choosing exemptions, must not forget that the tax system must continue to be transparent. Hence, the number of exemptions should be limited. A very complicated exemption system covering all details can be less effective than putting aside all exemptions and re-establishing the lowest tax rate, as exemptions can counter one another’s positive effects.

Although there are an unlimited number of exemptions which can be introduced, we would like to stress that the tax system should be made as simple as possible, and that the social-political goals of the local government should be separated from its tax policy.

Forms of exemption. Depending on how the local ordinance-drafting local government decides, and on the reasons for the exemptions, the forms of exemptions can differ. Exemptions based on affordability usually assist only those households for which the payment of tax is a difficulty. But fully exempting those not reaching a certain level means full freedom from taxation. There are some exemption types for the disadvantaged which in terms of the present offer full exemption, but only temporarily as in due time the full tax amount is paid. This is most applicable to the unemployed, because this kind of disadvantage is usually temporary. When disadvantage is long-term, but where there exists a valuable property, the burden can be passed on to the point where the property is sold or when the owner dies, in the form of an “inheritance tax” as mentioned above. This allows the local government to be fair, but to eventually receive its payment.

Citizens must be provided with the opportunity to claim exemptions throughout the year, as changes in life circumstances which lead to the need for an exemption can happen anytime.



Affordability

It is generally true that if the local residents feel the tax is equitable, they will be more willing to pay. A well-prepared and well-planned tax, should it be affordable, will be paid by the taxpayers, allowing the community to generate sufficient revenue. In that case, the local government has the opportunity to set rates at the lowest necessary limit and is not impelled to overtax those taxpayers that duly perform.

Once the local government has decided what level of revenue it expects from a new tax, it should decide how to distribute its burden among residents in the fairest manner and such that the distribution matches given social and political goals. In order to measure how given social groups will bear the tax, a survey can be undertaken. With an eye on the ability of families to bear the burden of the tax, the local government must use the study to determine the affordability of the tax for certain social groups.

Let's examine an example. The local government of Püspökladány would like to earn revenue of 90 million HUF through a new value-based property tax.¹⁷ The simulation shows that at a tax rate of 1.25 percent the local government gains revenue of 89.7 million HUF, should everyone pay. Tables 8, 9 and 10, using the method described above, show the average tax payment for households in various social groups. Tax payments in this scheme come out to 12,000 HUF per year for the average household.

The tables do not show only the average tax paid by household, but also what burden this implies on their incomes. For simplicity' sake they should the burden on the entire income of households, where attention should also be paid to indicators of income per family member.

Table 8
Tax Burden of Households by Status Group in Püspökladány

	Tax to be paid (HUF/year)	Tax/Income * (%)	Number of households
1 (lowest status group)	10,151	7.2	2,510
2	12,694	1.2	1,460
3	13,548	0.8	1,098
4	16,058	0.6	826
5 (highest status group)	22,394	0.7	811
All of Püspökladány	12,362	3.3	6,652

Note:

* Estimated annual income.

The tax is based on a rate of 1.25 percent of the corrected commercial value.

¹⁷ The numbers in the example refer only to simulation on residential properties. Revenue from commercial or corporate properties may be added to these amounts.

It is clear what differences come about due to the relationship between wealth (property) and income. The tax to be paid by the lowest-status social group is not quite half of what the best off must pay (see Table 8). Despite this, the proportion of income the tax represents for the latter group is 1 percent, while for the former group it is ten times this much. The payment of 10,000 HUF per year is likely too high for those families who are among the worst-off, and the amount must be alleviated.

Table 9
Household Tax Burden on Family Types in Püspökladány

	Tax to be paid (HUF/year)	Tax/Income * (%)	Number of households
1. Single person, active	13,337	6.4	512
2. Single person, inactive	8,342	5.6	1,271
3. Minimum 2 working, maximum 2 children	15,126	2.2	4,020
4. 1 working, min. 3 children	11,000	0.9	146
5. minimum 2. working, minimum 3 children	17,511	1.9	81
6. Old couples	13,476	3.6	622
All Püspökladány	12,362	3.3	6,652

Note:

* Estimated annual income

The tax is based on a rate of 1.25 percent of the corrected commercial value.

The impact analysis unambiguously shows that the residents of large homes with large families pay more tax, but that the differences arising as such are smaller than those when using household income as a measure. The tables also clearly show that in terms of the proportion of tax payment to income, the highest burden is put on single active and inactive (retired) people. As such, the local government can establish preferences tied to certain family types (e.g., the assembly of the local government might be particularly sensitive to the problems of large families), but this is not necessarily a social issue. As seen, large families hardly pay more than the average (just 3,000 HUF/year more than the average tax burden), while single retired people, despite the significant burden on their pensions, pay 4,000 HUF less (Table 8).

Household types confirm earlier observations. Those households which have an entrepreneur in them, and which are likely in a better material position, on average pay 50 percent more tax (just based on their residential property).¹⁸ Despite this the tax will be a burden mostly for households of retired persons, who pay an average amount of 4.8 percent of their income (Table 9).

¹⁸ Should the family have a separate property for business, its taxability will depend on the local ordinance.



In the end, the local government must have this type of information when it is planning exemptions. According to the data studied in this section, property tax is paid mostly by those with high incomes, but there exist critical groups where income and wealth/property are disproportionate. Two such groups exist: single people, who must pay the tax out of a single income, and households of retired people. The picture would look different if income per family member data were included. In such a case the list would be completed with large families living in large and expensive homes. The impact on these groups will be important to check after simulations of the income exemptions have been performed.

When establishing exemptions, the size of given social groups must be a factor taken into consideration. Should too big an exemption be given to a populous group, then revenue decrease may be significant, and the entire tax burden may have to be made up by other social groups. In the right conditions, exemptions tied to affordability and income can generally ensure that equity and tax morale increase. The burdens on various kinds of households should be checked in a second phase of the impact analysis, keeping an eye on the exemptions.

Table 10
The Tax Burden of Control Households in Püspökladány

	Tax to be paid (HUF/year)	Tax/Income * (%)	Number of households
Entrepreneur in the household	19,548	2.0	661
Unemployed person in the household	11,304	1.9	960
Retired person in the household	12,286	4.8	3,852
All Püspökladány	12,362	3.3	6,652

Note:

* Estimated annual income.

The tax is based on a rate of 1.25 percent of the corrected commercial value.

The Effects of Exemptions

Fairness-based exemptions. It is clear from the above that fairness exemptions are a rather complicated but very important matter in taxation. Among the several variations, we wish to examine income-based exemptions.

When defining exemptions, as mentioned above, two basic points must be taken into consideration: first is the achievement of the desired goals, and second is sustaining an adequate level of revenue. Table 10 shows the effects of various-sized income-based exemptions for the case of Püspökladány. We present three basic cases.

In the first we limited the tax payment per household to 1 percent of income, then at 2 percent for the second case and 3 percent for the third. In each case, we also consider three possible limitations on property value. It can be seen that the local government can lose considerable revenue (15 to 30 million HUF, see column four of Table 10, “no property-value limit”) if it does not plan the tax system adequately. It is also apparent that the politically-motivated introduction of the property-value limit, i.e., the easing of the burden only for homes under a set value, can lead to serious savings for the local government (see columns 2 and 3 of Table 10, property-value limit of 2 million, and 6 million HUF respectively). The low limit of 2 million HUF means the loss of only 4.5 to 8 percent of expected revenue (4 to 7 million HUF), while the high limit of 6 million HUF leads to a greater loss of 11 to 25 million HUF. The decrease in revenue in this case derives only from the exemptions for poor families. The better off strata must continue to bear the responsibility of paying tax. A limit can be established which brings about a tangible easing by making the tax bearable to poor families but which allows the local government to minimize loss of revenue without making the tax burden unbearable for other social strata.

Table 11
The Effect of Income-Based Exemptions on

Local government revenue (million HUF)				Tax paid by those of lowest status (1,000 HUF/household)			
Income limit (%)	Property value limit of exemption (million HUF)			Income limit (%)	Property value limit of exemption (million HUF)		
	2 mill HUF	6 mill HUF	none		2 mill HUF	6 mill HUF	none
1	82.2	64.3	59.5	1	7.3	2.7	2.0
2	84.4	74.4	71.3	2	8.1	4.4	3.7
3	85.8	78.4	76.5	3	8.6	5.7	5.0

Note:

The tax is based on a rate of 1.25 percent of the corrected commercial value of residential properties for the case of Püspökladány. In the absence of an income limit, the sum of revenues is 89.6 million HUF, and the tax payment per household of the lowest status families is 10,200 HUF per year.

Table 12 illustrates a case in which the local government seriously considers both the need for revenue and the easing of the burden on the most disadvantaged households. The local government, as in our earlier example, hopes for a revenue of 90 million HUF from property tax. This, as we have seen, can be achieved by taxing at a rate of 1.25 percent of the value of properties. After studying the impact analysis, local politicians decide that they would like to ease the burden on those with the lowest incomes, as it is unallowable to have 7.2 percent of their incomes taken away by the property tax. With an eye to income-related abuses, exemptions are denied those who are likely hiding a significant part of their incomes. Given that the tax department has accurate data on the value of homes, the exemption can be limited. Given local conditions, they decide that properties which are worth less than the mid-high value—



under 5 million HUF—are eligible for the exemption. This decision costs the local government close to 20 million HUF, as its expected revenue will decrease to 70 million HUF. The result is significant given that the tax payment for low-income households goes from 10,000 HUF to not quite 4,000, and the average tax burden decreases to 2.3 percent.¹⁹ However, given that the local government cannot get more from other revenue sources, and that it cannot reduce its expenditures, it must achieve 90 million HUF in revenue. Thus, the tax rate must be raised from 1.25 percent to 1.71 percent of the corrected commercial value of properties. The rise of the rate means an increase in payment per household among the best-off from 22 thousand to 30 thousand, and their tax burden goes from 0.7 percent to 0.9 percent. The tax payment of the worst-off grows by 500 HUF, on average.

This example shows how with the help of a preliminary simulation a local government plans the most appropriate tax in a way that generates sufficient revenue and at the same time is sensitive to the burdens of the taxpayers.

Table 12
Exemptions and Revenue

1. Original scenario			2. Original rate with exemption		3. Adjusted rate with exemption	
			Local Government			
Expected revenue *	89.6 million HUF		70.3 million HUF		90.1 million HUF	
Tax rate	1.25%		1.25%		1.71%	
			Households			
	Payment (1000 HUF/year)	Burden (%)	Payment (1000 HUF/year)	Burden (%)	Payment (1000 HUF/year)	Burden (%)
Low status	10.2	7.2	3.7	2.3	4.2	2.7
High status	22.4	0.7	21.9	0.7	30.0	0.9

Note:

* Only tax on residential properties is considered in these calculations.

In cases 2 and 3 the exemption is as follows: in the case of those living in properties worth under 5 million HUF the tax can be a maximum of 1.5 percent of income

It can be seen that the local government that thinks it important to make its new tax fair can make it so based on income-related exemptions. Should it take into consideration the ownership of well-documented properties (in this case homes) or the value of properties, the planned tax can be even more goal-oriented. When planning exemptions attention must also be paid to the fact that should an expected level of revenue be sustained, exemptions granted to one social group must be made up by another. Given this, exemptions must be planned with care.

¹⁹ The property value, because of the limit, does not exceed the maximum income limit, hence the local government is taxing progressively.

Exemptions based on local political preferences. We have mentioned that the possibilities of local politics are boundless in that preferred groups, neighborhoods, or even property types can be partially or fully exempted from taxation. An exemption system can even motivate residential investments. In the majority of cases such exemptions are harmonized with social expectations: e.g., “everyone has a right to 25 m² of living space.” The result is that in the case of an otherwise well-planned tax, even despite exemptions the original tax must be paid, only based on a higher rate. Too large an exemption, like 25 m² per household resident, can lead to a significant decrease in the number of tax-paying citizens, meaning a small number of residents will have to pay very high taxes, or the local government will have to give up its expected revenue level. Table 13 shows how important the estimations of the effects of exemptions are: in an extreme case a poorly measured exemption can reduce revenue to 1/80th.

Table 13
The Effects of Various Local-Preference-Based Exemptions on Local Government Revenue (1,000 HUF)

12.a Effect of space-based exemptions on total revenue (1000 HUF)				12.b Effect of exemptions on total revenue (1000 HUF)			
<i>Exemption per child (m²)</i>	<i>Tax-free floor space (m²)</i>			<i>Exemption of smallest tax (HUF)</i>	<i>Maximum tax payment (HUF/household)</i>		
	—	50	100		20,000	50,000	100,000
10	81,954	23,702	1,264	1,000	77,788	85,875	87,370
15	79,251	22,076	1,090	2,000	77,686	85,773	87,267
20	76,581	20,919	1,004	3,000	77,652	85,739	87,233

Note:

The tax rate based on floor space used in the tables is 250 HUF/m², while the value-based tax rate is 1.25% of corrected market value.

In the case of property taxes, exemptions are commonly granted in relation to the area of the apartment or to the number of residents. The first, from a expert viewpoint, we do not recommend at all, and we have serious reservations about the second. Exemptions based on floor-space (be they per dwelling, per resident, or per child) undermine the fairness of the value-based tax, as they grant a larger relief to those living in more expensive homes. Further, it can be said of exemptions based on floor-space per home, which are not uncommon in Hungarian practice, that:

- When they are too large they can significantly reduce the number of taxpayers
- When they are small they have the same result as having introduced the tax with a lower rate.



In our calculations, we took into consideration the desire of some local governments to drop minimum payable tax to a certain level (under which the tax payer would exempt), given that the administrative cost of collecting such sums is higher than the tax collected, or that it would affect groups which deserve to be exempted. As there are arguments for foregoing taxes under a certain minimum, there are also arguments for setting a maximum limit: for example, the tax may represent contribution to local expenditures, and thus disproportionate differentiation is unjustified. Further, property taxes which are too high can scare taxpayers away from the city, and thus can negatively effect local economic development.

Exemptions granted at too high a level can lead to the ruin of general and proportionate distribution of burdens, and expected revenue can only be sustained by overburdening those who are not exempted. It is thus important for local governments to precisely measure the level of revenue required to meet its expenditures, and to spread the tax among taxpayers in the widest possible manner with a simple but fair tax system. As transparency is one of the fundamental goals (it is necessary when trying to gain the trust of the residents), we suggest that social policy programs be separated from the development of the tax system. We would like to stress that often the simplest tax systems are the best, and for this reason the local government must be cautious when working out exemptions. When defining exemptions, the most important issue should be supporting the affordability of the tax.

Impact Analysis and the Willingness to Pay

The most difficult task is to estimate in advance the citizens' willingness to make tax payments. This is the most unsure part of the impact analysis. The questionnaire in the appendix repeatedly attempts to identify those who potentially would refuse payment, but the ultimate decision on evasion is made by citizens in the concrete situation in the light of the actual circumstances at the time the tax is levied. Despite this certain indirect tools can be used when studying the residents to test expected resistance and the reasons for it. Based on this, the communication strategy can be designed to persuade residents to pay duly.

In practice, local governments and public services often build the costs of outstanding debts into their prices, meaning that those who pay are punished in place of those who do not pay. Should the local government, when designing the tax, take into consideration willingness to pay, and should it have designed fair exemptions benefiting those in need, then it is important to be strict with those who do not pay. Should this not be done, tax morale in the city will deteriorate.

Political Decision Making: The Local Tax Ordinance

The planning of the tax, through the decision of the assembly, is embodied in the local tax ordinance. Should a local government wish to introduce the form of tax recommended in this

study, then the local tax ordinance must cover the method of property-value appraisal. Given the contradictions in the legal conditions, this document must define “commercial value” estimation, i.e., that the local government will make calculations based on the average commercial values and modified by correction factors. Given that appeals will target the appraised commercial values of properties, their definition must be very precise. It is important to make public the formula used to establish property value, though it must be acknowledged that the formula cannot always be part of the ordinance, given that it may not have been completed by that time. In Canada, taxpayers can use computers set up in the Mayor’s Offices to get tax information, thus insuring that the process is an open and public one.

It is very important that other issues concerning property appraisal be spelled-out clearly in the ordinance: the annual correction method and its limits, the establishment and maintenance of the property-related information system, the upgrading of the formula every 4-5 years, the conditions of indexing, and the handling of unacceptably large shifts.

IV. COMMUNICATION STRATEGY²⁰

Political leaders must take actions that both respond to the needs and interests of citizens and at the same time ensure that citizens understand and appreciate those actions. The introduction of a new tax is an occasion on which these two responsibilities are difficult to reconcile, as citizens will naturally see it as primarily a demand upon them to pay more and will not readily perceive the necessity of the tax or the benefits it will bring them through city services.

In this situation the role of communication becomes especially important, and a well-constructed and well-executed communication strategy can greatly facilitate this critical aspect of governance. The policy can be defended by showing how the new tax meets the needs of the public. Success can only be counted on if the message of the new burden on the residents is in tune with the original policy strategy of the municipal government’s leaders, which truly takes into account local social and economic needs.

Designing a Communication Strategy

The design, enactment and implementation of the tax policy must be comprehended as part of an integrated process from the point of view of communication. Effective communication can assist local governments to get feedback in the planning phase and foresee and correct problems before they appear in reality. A communication strategy can help politicians develop an effective rationale for the new tax and help mediate conflicts before they escalate, thus making it easier for decision makers to take the political risks associated with raising taxes. As with most other

²⁰ Section IV (“Communication Strategy”) was prepared by Sharon Cooley, Katharine Mark, Szabó Yvette and Varga Kristóf.



policies the success of a new tax ultimately relies on its implementation. An informed public which was made part of the decision making process is more likely to comply than a community taken by surprise, saving time and energy for administrators of the tax.

The main objective of the communication strategy is to inform the citizenry—as well as local government staff and elected officials—of the following:

- A tax will be introduced
- Why it is necessary
- How it will work
- That it is fair
- What exemptions there will be
- What is expected of each taxpayer

The most important elements of the communications strategy in introducing a value-based residential property tax are as follows:

- Coordinating the communication strategy with the local government's overall tax policy.
- Identifying the target groups.
- Articulating the message and supporting arguments.
- Identifying the principle communicators of the tax.
- Correlating available communication channels with their use by individual target groups.
- Assessing the success of the strategy.

The following takes these elements one by one and outlines the issues to be taken into consideration for each one. It should be noted at the outset however that there is much overlap and they should by no means be interpreted in linear fashion.

Coordinating the Communication Strategy with the Local Tax Policy

As has been previously stated the communication strategy is an integral part of the overall design of the tax. The timeline presented below demonstrates the stages of this process, and potential time frames for each stage. Further elaboration of certain elements of the process are provided in the remainder of this section.

Table 14
Implementing the Tax: Design, Introduction and Communication Strategy

Policy Action	Description of tasks	Communication
Month 1		
Decision to introduce the tax	The city leadership determines that an increase in revenue, and hence the introduction of the new tax, is necessary. Limited professional and political debate begins, and expectations for the value-based property tax are outlined.	Discuss with staff and key council members
Staff conducts preliminary analysis	Local government leaders ask staff experts to determine what measures would make the introduction of the value-based property tax possible. The mayor must be prepared with good arguments on why there is a need to introduce a new tax, and what advantages will come of it.	Announcement to city council, formulation of arguments
Committee debate	Assembly passes necessary bills on hiring experts, allocating funds for simulation studies, surveys, and other tasks. Announcement to the public that financial policy is under review, emphasizing the link between revenues and services.	Press release on general financial reform.
Months 2-7		
Analysis and preparation of tax options	Staff analysis. This is one of the most labor-intensive and time consuming phases of the introduction of the tax, undertaking surveys, analyses, and preparation of taxation options. May include the help of outside experts. Regular communication with the council and committees on the findings of the preparatory work is important during this phase.	Keep council informed of progress.
Options for tax design finalized	The outlines of who within the local government support and oppose the introduction of the new tax should begin to take shape. Preparation of appropriate arguments for the legislation phase must take place.	Refine arguments according to target groups.
Months 8-9		
Recommendations and council debates	Staff recommendations are presented to committees and the assembly for consideration.	First public announcement that a value-based property tax is being considered
Council debates ongoing	Before the debate begins, clear public announcements are necessary as the press and media will report the events taking place in the assembly. Press announcements are prepared, which emphasize the link between services and taxes, the need for new revenues, and some key points about the options being considered. This allows the public to be informed of the plans by the local government leaders first-hand.	Concerted press and public awareness campaigns are conducted
Assembly decision on tax design	Press conference on the day the assembly takes a position. A community forum or public hearing on the planned new tax could also be organized. The detailed introduction of the alternatives and arguments for value-based property tax. Informing the staff of steps to be taken. The identification of further orientation and information options (toll-free number, or orientation pamphlet, e.g.). In terms of persuading the prospective taxpayers, this is one of the most important phases. Should serious opposition be encountered, response should be immediate. Local leaders themselves should take up the initiative. It is worthwhile to invite those affected and the representatives of the opposition to begin dialogue.	Press conferences and public hearings are held, and dialogue with concerned persons is initiated
Month 10		



Policy Action	Description of tasks	Communication
Staff review and refinement of the tax design	Final review of proposed tax design from the technical, policy and citizen perspective. Preparation of detailed tax regulations and schedule. Collect information on tax base.	More refined response to citizen concerns is provided
Months 11-12		
Submission of proposal to the Council	The submission of the proposal to the representative assembly. Debate in committee meetings, then in the assembly. Continuously informing the press and media of the goals and arguments concerning the new tax. This is a critical phase of communication, as it will significantly influence the assembly's decision.	Continued press outreach
Assembly passes resolution	Series of orientation forums and press campaigns to begin the day the assembly passes the resolution. Planning the remaining schedule in accordance with the local government resolution. The local government must have clear, readable, user-friendly descriptive materials ready for distribution. At this time, it should also announce a source for additional information or answers to questions, such as an information center with office hours and/or a special telephone number.	Intensive public outreach. Establish information sources.
Month 13 (3 months before tax due)		
Send out declaration forms	Declaration forms are sent out along with instruction sheets, giving a two week deadline. This is a critical point since for many residents this will be their first encounter with the duty of paying tax. The letter present the strongest arguments for the introduction of the tax, and should clearly and understandably explain the taxation process and the means of obtaining further tax-related information. Here the necessity of tax collection and the tax collection process should be explained, and appeal process and penalties made clear. From this point on the staff of the affected departments and the client service department become the most important communicators.	Clear explanation of tax to all potential taxpayers.
Month 13 (2 months before tax due)		
Assessment begins	Mail out reminders to all taxpayers who have not returned declaration. Begin process of verification, and initiate legal action as appropriate. Begin assessment with received tax declarations.	Mail out reminders. Continued public outreach
Month 14		
Distribution of tax forms	Mail out the tax bill one month before the tax is due. New information on and arguments for the tax should be passed through the mass media.	Continued public outreach
Month 15 (Tax Payments Due)		
Intake of tax forms	Receive and process all tax forms. Send acknowledgments promptly; where forms are not filed, send inquiries promptly, with notification of penalties.	Clear and prompt communication with tax payers
Months 16-22		
Evaluation and corrections of the tax policy	The evaluation of experiences by the staff, committees, and assembly, to take place after the first tax collection or at the end of the first tax year. The evaluation of the introduction of the tax and the communication strategy by a special working group. The drafting of necessary corrections. Release public information on total tax revenue and spending.	Report to the public on the success of the policy and/or planned improvements

For the communication strategy to succeed, it is essential that municipal leaders make decisions in the first phase of planning the tax which are in tune with the original policy strategy. They must ensure that when introducing the tax they do not contradict earlier promises (e.g., tax burdens will be lowered), or if such contradiction is necessary, its necessity must be explained with appropriate reasons (e.g., the external environment has changed, new goals have appeared). The need to coordinate the communication strategy with the exigencies of the tax policy will persist throughout the entire implementation process, from initial planning stages to actual collection.

Identifying the Target Groups

Although the entire citizen body must be fully informed of the new tax—its rationale and overall effect—it is essential to differentiate among various sub-groups of the general populace. These groups may differ in their level of involvement and role in the tax project, in their extent of understanding the tax system in general, and in their ability to digest and access information on the new tax.

Typically the target groups can be divided into two major subgroups: internal and external.

The internal subgroup is comprised of:

- City staff
- Local politicians, with special attention to key players such as the Mayor, committee chairmen and party caucus leaders in the assembly

While the external group might include:

- Citizens of Püspökladány
- The local media
- The national media
- Other potentially concerned authorities, such as the Ministry of Finance, local government associations, and county authorities

It is important to define the characteristics of these groups in order for the local government to create tailor-made communication strategies for each group's specific concerns, interests, and needs. Citizens obviously have less information on the tax system in general than staff members of the City's Tax Office. The local media is more interested in the immediate effect of the new tax on local taxpayers than the national media, which may comprehend the tax project as an example that other municipalities around the country ought to follow. Members of the internal group typically need to be informed before members of the external group get the details. Although this will be discussed in greater detail below, channels of communication can vary among the



subgroups, as well. Finally, the groups singled out above are, of course, just an example. Target groups need to be rethought in each particular situation. For example, in a city with a sizeable business community, it would be important to communicate with members of that group in a specific way, rather than treating them as part of the general population.

Local politicians play a crucial role in the success of the project because ultimately it is the majority of the council who decides whether the new tax will be introduced. It is recommended that members of the council are involved in the process early on, so that they won't feel they have been shut out of an important decision-making process. In this way they may be less likely to reject the policy outright owing at least to misunderstanding its necessity and content fully.

It is difficult to predict the response of prospective taxpayers to the new burden. The local government's traditional forums, such as public hearings and community forums, can be of some assistance, as can the local media. It is clear, however, that in this beginning phase it makes sense to first have the communication center on the local government's need for new revenue in order that it may sustain or increase the quality and level of service provision, and what options exist, rather than start by mentioning the introduction of a new tax.

This preliminary discussion can take place in interviews given to local newspapers or TV stations, or a piece may be written for the local government newsletter, in which the citizens are asked to forward their opinions to the mayor's office. Telemarketing tools can be used as well: citizens can make use of the local government's regular phone numbers or a toll-free number to express their opinions and recommendations. It must be acknowledged, however, that such opinion expression is characteristic of only a slim group, thus opinions collected in this way are not generalizable.²¹

In addition to learning about how citizens get their information, specially designed surveys can be useful for ascertaining the mood of the public toward accepting a new tax and the types of services they may be willing to pay more for. These surveys provide insight into what strata in society might be more likely to accept the new tax and who might more stringently oppose it. Surveys also help identify those groups within the larger population with whom it will be particularly important to communicate, that is influential community leaders, as well as provide information about citizens' willingness to pay—and for what. For example, in the Püspökladány survey, approximately one-

²¹ A survey conducted in the Spring of 1999 in Püspökladány, for example, demonstrated that only 2 percent of the respondents mentioned that they have ever been to a public hearing, and only 1.5 percent have participated in an assembly meeting. Only 16 out of the 400 surveyed (3 percent), have turned to the mayor's office with a question or complaint. However, 56 percent of the residents of Püspökladány follow the council activities through the local paper, while 46 percent follow it on the local TV.

third of the respondents mentioned that they are not willing to pay more taxes and an additional one-third said they are only willing to make sacrifices for common goals when they know on what concrete program the municipal government plans to spend their tax money. From this it follows that the message sent by the municipal governments ought to contain some indication as to what the revenue from property tax will be used to finance.

In Püspökladány, for example, residents consider the most serious problems to be unemployment (36%), public safety (26%), and the level of the city's cleanliness (31%). When asked on what they would prefer to spend local taxes, the majority responded with health care (36%), but housing construction and caring for the homeless were also popular (22% and 18% respectively). Supporting elementary schools (18%) and improving public hygiene (19%) also figured in the responses.

Clearly then, residents of Püspökladány would be most willing to take on a heavier burden if they are convinced that such an act will lead to the solution of the above-mentioned problems. For example the city might want to announce that in the year 2000, its priorities will be education and improving health care. This would respond to the broad interests of the populace, including both the opinion leaders and those most likely to resist the new tax. It is important to emphasize that such promises must be coordinated with the actual capacities of the city.²²

During the initial planning stages, the identification of the target groups and their respective concerns can be narrowed down considerably and communication packages designed which take these concerns and relevant media channels into account.

The Message

The most important task for communication is the precise and clear articulation of the message. The message needs to be given weight by rational and sound arguments and supporting information. In order to identify the elements to stress in the communication strategy, the so-called Saatchi model is of assistance in grouping these issues according to degrees of popularity and importance. It should be stressed, however, that despite the fact that Group II will be the most difficult arguments to formulate, they must not be avoided in the communication strategy.

Table 15

²² The survey in Püspökladány revealed that if the local government wishes to communicate with those who consistently follow the fiscal management of the city, then it must take into account that these better-off and higher educated strata express a greater-than-average desire to support education (28%) and pre-school (15%). Those who by no means want to pay a new tax are generally poorer and older, and as such they are more concerned with public support for health care (20%), various social assistance programs (14%) and the support of old-age homes (9.6%).



Saatchi Model

	Important	Unimportant
Popular	I. Must be emphasized	III. Should be employed to enhance other arguments
Not Popular	II. Must argue	IV. Should be avoided

Group I. Those issues which are both important for the city's policy strategy and correspond to the needs and desires of the target groups *should be emphasized* from the outset. Presenting them first will help win over the approval of citizens. For example: "new tax revenues will lead to improvements in services." The message should attempt to specify which services are most likely to be affected: "In the year 2000 the city's priorities will be education and health care. Some of the revenue generated by the new tax will also be earmarked for a new elderly home [or a new swimming pool, to improve road conditions, etc.]."

Group II. There are some issues that will be unpopular among the target groups, but which are of crucial *important* for the acceptance of the new tax on all fronts. These issues *must be argued*. It is important to note that if these "unpopular" arguments are clearly and persuasively presented, they can bolster the local government's case. For example: "Local services and the meeting of the needs of residents requires revenue"; "Reduced central funding must be compensated for."

Group III. Some issues are not important from the city's policy perspective but because they are popular can help support the new tax. For example, existing exceptions from the previous property tax will remain in force, a provision which will at least appeal to those eligible.

Group IV. It must also be *noted* that factors exist which are unpopular among certain target groups and which are not important in terms of the overall message. These questions *ought to be avoided* when addressing these target groups. For example: "the value-based property tax automatically increases annually." On the other hand, this same message might be an important issue for the local government staff to understand, beyond the fact that in economic and political terms the value-based property tax has advantages over other types of taxation.

Broadly speaking, the message should contain, but not be limited to the following:

ISSUE	ARGUMENTS AND INFORMATION
Why there is a need for the introduction of a new tax	Sustaining or improving the level of services requires new revenue (specifying which services are most likely to be affected)
Alternatives for city policy among which the local government and those affected may choose	The communication target groups must always feel that they have choices, while all the choices must guarantee that the local government can achieve its goals
Why introduce the value-based property tax	It is fair because it places less burden on those less able to pay, it has certain advantages over other types of taxes, it increases the responsiveness of local governance and fiscal transparency
The characteristics of value-based property tax, and whom the tax will affect	When it will be introduced, which properties it applies to, the basis of the tax, how appraisal takes place, the maximum possible burden, what exemptions are planned, what sanctions will be brought against those who don't pay
How tax assessment will take place and who the tax collectors will be	The schedule and timing of tax assessment and collection, the roles of the local government staff, the costs of the tax
How much will the tax cost the taxpayer	The tax burden will never be more than 3 percent of the commercial value, only 50 percent of the real value of the property will be taxed, the validity of the exemptions from the pre-1990 house tax, other exemptions, other concessions (such as letting the taxpayer decide on what service a pre-established percentage can be directed toward)
Answers to arising questions and grievances	Possible responses to complaints, arguments against counter-arguments, reactions to potential problems
Where information on the new tax is available	The introduction of communicators, the announcement of orientation forums, the advertising and publicity of orientation publications and sources of information



The Saatchi matrix *presented* above can provide guidance regarding the initial importance that might be given to each argument. Nevertheless, for each of these questions—and many more that might arise—it is important to find ways to disseminate the information. In some cases, the local government needs to foresee difficult questions that may arise—for example, “Aren’t citizens already overtaxed?” or “why don’t you tax businesses instead?” and prepare answers for them. The section of the Appendix entitled “Sample Questions and Answers for the Property Tax Communication Strategy,” provides a list of such questions and draft answers that may be helpful.

The Communicators

After identifying the target groups and the message, one must decide who will do the communicating. The choice of communicator, given the experiences of the municipal government, will be relatively obvious, though it is worth noting that when selecting a communicator, important factors are personality (the communicator should be someone important as far as the issue is concerned) and communication skills (the communicator should be convincing, expert-like, likable). Further, communicators should be able to work together in order to present a unified message and thereby increase credibility. In the case of such an important message as introducing a new tax, the most important communicator is probably the mayor, who should personally meet and communicate with all target groups (tax department, the entire municipal staff, various groups of taxpayers, government officials). Another important role is that of the expert (most likely the director or staff of the tax or finance department), who is the coordinator of the technical work. The expert must give professional reasons that support the mayor’s, and later the council’s, political decision.

The mayor and the leader of the tax department are the ones who will also most likely handle the press and media relations. Nevertheless, the staff of the mayor’s office must also be prepared to present information, and later, after the final policy decisions and decrees of the assembly have taken place, the entire tax department and all representatives must be prepared to answer questions related to the tax.

It is worth noting that in Püspökladány the majority of people turn to the local government department officials or to the client service department when they have a question or complaint regarding municipal services and issues. Very few remarked that they seek out the head of the department, the mayor, or council representatives. Out of those who made some contact with the local government within the past year, one-half approached in person, while the remaining used the telephone or post (50-50 respectively).

Communication Channels

The communication channels must be chosen at the same time the local government is working out the schedule of the communication plan. Communication of the new tax should, in theory, go through well-tested communication channels and means (orientation and debate in the working groups of the local government staff and legislature, committee meetings, orientation letters, flyers, announcements, perhaps even telemarketing, toll-free phone numbers, press conferences, orientation through the press, the media, and other means).

For the leaders of the local government the channels through which they can reach the staff and representatives (information meetings, committee-, fraction-, and assembly meetings, informal channels) are obvious. It is, however, much more difficult to judge which channels are most effective in reaching the entire community or the target groups. The survey was helpful in showing how various groups of people get their information. The majority get it from local newspapers (56%), but several (33%) read county newspapers and a significant number follow the local media (47%). Residents of Püspökladány get information about the local government over the radio at lower-than-average rates: only 16 percent of the respondents did so. Only about 1.5-2 percent of people participate in legislative meetings and public hearings, and advertisements reach only about 4 percent.

The survey also maps out which social groups are reachable through which communication channels. Those who say they follow closely the fiscal management of the municipal government read the newspaper and watch television (the more well-to-do and the youth also enjoy the radio) at higher rates than the average, and it is more characteristic of the higher social strata to go to the Mayor's Office in person. Those of the highest social status (most likely well-off entrepreneurs) are receptive to advertisements.

Evaluation and Measurement

The goal of communication is not just persuasion. Communication also allows local leadership to measure how their activities are being received. The experiences gained through communication (in professional debates, staff meetings, assembly meetings, community forums, press interviews, use of toll-free numbers) and the opinions collected should be built into the definition of the final form of the tax. In this way the local government can increase the technical and political base of the tax, raise its level of acceptance, and improve its own image. Evaluating the success of communication can help the local government assess its work all around, allows for necessary corrections, and lays a foundation for the successful attainment of policy goals in the future. For the sake of evaluation, communication goals should be



measurable, and this should be taken into account when defining goals. In this way, the following should be measured:

- The quantity of tax revenue the local government hopes to achieve, and the level of actual tax revenue
- The quantity the local government has earmarked for administration and the size of the actual expenditure
- The percentage of taxpayers who have heard of the tax in various phases of its introduction
- The percentage of taxpayers who accept the introduction of the tax
- The number of taxpayers who make mistakes on their tax forms
- The percentage of local government staff and assembly members who support the introduction of the new tax
- The number of appearances per communication channel planned by the local government, and the actual number executed (the number of articles, interviews, forums, orientation materials, etc.)
- The cost of communication and the proportion of the number of people reached (communication cost per person reached)

Conclusion

It is clear that the introduction of a value-based property tax requires a comprehensive communication plan, and if the municipal government is prepared and can openly communicate with those to be affected, then it can be sure of success. This form of taxation itself can ease communication, as it has several advantages which serve as 'pro-' arguments, and what's more, there is no need for annual debate on raising tax rates and ensuing communication. Leaders of municipal governments, no matter which communication strategy is adopted, are helped by the fact that they have the biggest publicity in the locale, and if they make good use of their communication channels, then they may help define what issues will become important, and what the themes are addressed in local political discourse.

V. ADMINISTRATION

The implementation of the ordinance issued by the decision-makers is the responsibility of the tax departments of the local governments. Those cities and tax departments which had previously not had a residential tax, or which taxed only a small and limited portion of the residents, encounter a major increase in expense. Whether most of the expense is incurred when first introducing the tax, whether it is continuous, whether it means just an increase in the number of clients, or whether it entails hiring outside experts, is largely dependent on the appraisal technique chosen. The increase in administrative costs must be built into the revenue expectations. For this reason, the city must, in light of its characteristics, seek the least expensive solution possible, while at the same time not putting revenue expectations at risk.

Administration seems to be the area in which local governments are most free to make decisions within the framework of the specific law, and such decisions will determine whether tax collection will be easy or difficult.

What are steps are entailed in these administrative decisions? The first step is to identify taxable items, and then the taxpayers, and then to compare the two lists. This phase is followed by requesting the taxpayers to submit a declaration, then the review of the declarations and then levying. Then comes the phase of appeal, which is followed by collection. Should the local government succeed in imposing the new tax, then two phases remain: control of performance and compelling non-payers to pay, i.e., enforcement.

The Identification of Taxable Items and the Taxpayers

The local governments which have not as yet taxed residential properties encounter a new type of tax with a much larger number of items than those of earlier local taxes. As, according to the law the tax is to be paid by the owners (i.e., the person with the rights to the value of the property), before the tax is introduced records are to be produced on the properties of the town and on their owners. Such records are generally not available with the tax section of local governments which have never before levied a tax on properties. How can such records be obtained, how can they be composed? ²³ Generally it can be said that only those local governments which had established data bases for earlier property taxes have complete records on properties and their owners. Naturally, this means that database construction will be a problem for local governments only for the first year of introduction. This is so because updating, as when properties are sold, is in the direct interest of the old owner, making life easier for the tax departments.

²³ In the case of newly-built properties, or when major reconstruction takes place, the owners must ask for permits from the local government, but these two lists are not complete for two reasons. In some cases of major reconstruction or extension, the owners did not apply for permits. Further, the list can be incomplete for legal reasons, as the list only contains data on the original owners of the property, and not on the changes in ownership. For these reasons local governments should compose their records using outside sources.



How can the data be obtained? The possible sources of data have one common characteristic: the sources cannot be obliged to submit data free of charge to the local governments. The most obvious sources would be the Land Offices of the Counties, but they would charge a high price for the official supply of data (e.g., the County Land Office offered their data to the Püspökladány local government at a cost of 500 HUF per property). Free data can only be obtained through personal links. In this respect the bill on the modification of the act would offer a favorable development, but for the time being we have to wait for the modification. Of course these data bases are not always complete, as they can, for example, contain registrations concerned with property value rights which, though no longer in effect, have not been removed from the record (e.g., utilization rights until death). Demarking these means more work for the local government, should it be able to obtain the database in the first place.

Most public service firms have lists on the names and addresses of their consumers, but such data bases are not complete, and perhaps not fully updated. However, they are generally better than the lists available with the local governments, so they may be used as a starting point. But in both cases there is the problem that the local government does not have a full physical description of the properties which would be needed for appraisal. The only means of gathering such data at the beginning is residential declaration.

Declaration – Supervision – Levying

Once the taxpayers and the taxable items are identified the second phase, namely the submission of tax declarations, may follow. Here the previous database is expanded by including data on the physical parameters of the structures. The tax office will have to monitor only two things. First, all data needed for the appraisal technology on the property should be stated on declaration forms. Second, as this will be the phase when the tax department first encounters the new problem of maintaining links with such a mass of taxpayers, it must prepare itself for mass correspondence. It is thus suggested that administration of the taxpayers be computerized, which, in ideal cases, releases the office from the manual addressing of tens of thousands of envelopes, and it may also be cheaper than the employment of additional staff.

Naturally the incoming declarations need to be checked. This process is one of the most important parts of the introduction of the new tax, and it is one of the most time-consuming. In the ideal case, should there be enough time, then verification should take place in the year previous to the introduction of the tax. Should this not be possible, then control must concentrate on missing data, and random reviews of declarations should be undertaken. In the following years one of the most important tasks of the tax department will be the comparison, maintenance, and upgrading of databases. In the next phase the local government will need to mail out the tax payment amount to every property/owner. The technical difficulties of making these calculations and information technology capacity-need will depend on the appraisal technique.

Another problem occurs when a property is sold during the fiscal year. Up to the end of the given year, the old owner will be obliged to pay the tax even if the property was sold during the first half of the year. But the tax liability for the second half of the year is mailed to the old address, and even if the old owner does receive the notification he/she may not willing to pay the tax, once he/she uses the public services of some other town. The problems arising from the sale of property during the year will raise concerns especially in cases where the new property owner comes from another town, and thus, obviously from a different local tax system . To manage the issue the law should be amended, because for the time being the law unambiguously states that the status at the start of the year will apply up to the end of the same year.

Appeal

Many more problems arise in relation to the period of appeal after the taxes have been levied. As the local government wanted to establish the market value by appraisal, and the market value in most cases cannot be identified with precision, it can be subject of dispute. If implementation is not halted in the first phase, this will be the point where the tax of the best construction can fail, should masses of taxpayers appeal against the value ascribed to their properties.

Three factors can operate against masses of appeals. One is an important issue for the decision makers, namely, the selection of an appraisal technique which requires the least possible tailor-made, discretionary estimations, whereby—in the case of adequate publicity—appeals must be targeted against the entire appraisal technique, which is not possible. The second is that, for this reason, it is suggested that specified values be grouped or that some other flexible solution for appraisal be used (e.g., if the local government regards the lowest limit of a determined confidence interval as the market value for estimation purpose). This provides the biggest possible flexibility for the appraisal. But for given reasons, we do not feel this is a good path to follow (see Table 5). The third counter-motivation belongs to the execution phase, as, naturally, the appeal should not be free of charge for the taxpayers. Only that taxpayer who expects his/her case to be won will submit an appeal, because once the appeal reaches the court phase, the cost of the expert, that is 1 percent of the property to be appraised, will have to be paid by the losing party, and such cost may be higher than the potential benefit to the taxpayer.²⁴ Let us not forget, that even if the taxpayer wins the case, he/she will have to continue paying tax, only at a lower rate. The sum of tax saved (and given the uncertainty of the appeal decision, this sum may be zero) will be much smaller (when using a well-constructed appraisal procedure) than the expected cost (i.e., the

²⁴ In accordance with the legal regulations found in the law on duties, a 3000 HUF increase of the appeal duty would significantly decrease the number of unfounded appeals. Such an increase in the duty could be introduced through a central regulation, or by passing the right to introduce the increase (limited, let's say, to no more than the costs of appeal) to the local governments.



entire cost of litigation). One solution is to publish the formula of appraisal, so that every taxpayer may know the objectivity of the appraisal applying to him/her, and hence, when comparing the expected costs and benefits discussed above, would think twice before appealing. (A possible method for handling this problem is the introduction of the tax-concession used by the local government of Eger, whereby those who make both their tax payments in March receive a discount. In this case, should the taxpayer want to appeal, he/she may lessen his/her annual tax payment, but having missed the first payment deadline, he/she will miss the discount, meaning that the appeal will only be economical in extreme cases.) The communication strategy of the local government will have a major role to play in the solution of such problems.

The third disincentive to appeals contains a fourth one. Let us not forget that should the appraisal method be public (even if the value for individual properties is not made public) then all those who wish to sell their properties in the future will know that the appraisal value of the local tax authority is a piece of information which potential buyers will seek. Hence, appeal has a hidden cost, in that it will lower the price that the property can be sold for in the future. This is particularly true in areas where access to real estate information is limited (foremost small provincial settlements). In this case the appraisal of the local tax authority can have a very important effect on the values of local properties. (Because of its positive effect on the real estate market, we feel that legislation should make it possible to appraise properties which are for some reason exempt from taxation).

Naturally, the establishment of value is also a matter of trust between the taxpayer and the local government, and for this reason it is suggested to introduce a system of appeal which will increase such trust. It may help, for instance, if the local government automatically accepts the appeal if the citizen can submit a sale and purchase contract on the property which is not older than one year, and is attached to the appeal. It is recommended that the appeal procedure remain within the local government, as the higher public organizations will not accept the risk of the litigation, and for formal reasons will send the appeal claim to a lower level.

Another fear of the local governments are appeals for fairness—when the taxpayer does not question the legality of the tax—which must be prevented with a well-prepared exemption system. Those who further have appeal requests must be put through the normal appeal process—regardless of the content of their appeal—where even in the case of denial of the claim, will incur an extra expense for the local government. Such equity-based claims can be prevented, should the exemption system be rational, and should the communication strategy clearly state the message that only those who somehow fell through the cracks of the exemption scheme should claim exemption. Overall, appeals will be minimized if the tax is perceived to be fair, appraisals not arbitrary, and the entire process as transparent as possible.

Checking Performance – Enforcement – Forfeiture

Once the deadline for appeal is passed, the tax payment performance of the taxpayers must be checked, then payment must be enforced, in some cases meaning the payment of their salaries should be garnished, or movables, then properties be sequestered: these phases are fully specified by law.

As the implementation of the various administration steps takes time, it is suggested that the new tax be introduced one year before the deadline for the first performance.

VI. SUMMARY AND RECOMMENDATIONS

Over the past few years, the real value of central revenue of local governments has fallen significantly. For this reason, the role of local revenue has grown, and this trend will continue for the foreseeable future. At the same time it is desirable that local revenues take on a bigger role in the financing of local government in order that the local community may strengthen control over local government financial management. The growth of local revenue can be achieved through the development of local tax systems, the introduction of new taxes, and the growth and restructuring of existing taxes: this is especially important as property for privatization has largely been depleted.

One possible alternative is the value-based property tax and plots. Despite the fact that this has been a legal possibility for local governments since 1990, only two local governments have introduced this tax. The goal of our study is the examination and introduction of this tax, presenting arguments for the introduction of the value-based property tax, how it may be introduced, what problems the local governments might face given today's legal regulations, and what possible remedies exist.

Although our study is foremost about property tax, the majority of thoughts and methods presented also apply to tax on plots, which can be a successful supplement to property tax. The study concentrated on taxing residential properties, mostly because we felt that taxation on non-residential properties came with fewer (and different) problems.²⁵

In our study we showed that the introduction of value-based property tax is a realistic and desirable alternative for Hungarian local governments, given that this tax type is capable of securing stable revenue at real value for local governments, through

²⁵ The biggest difference is that the value of non-residential properties cannot at all be based on commercial values or calculations. In such cases the potential income from rental or the potential profit are the foundations for appraisal which must be used. The structure of our study followed the schedule of a recommended schedule for the decision-making mechanism of local governments.



utilizing the widest tax base. We further showed that this tax type best meets the demands of fairness in a country with a high level of black market activity, where the rate of hidden income is extraordinarily high.

We also showed that an appraisal method can be introduced within the confines of current legal regulation, this being appraisal based on calculated value, with whose help the value of properties can be estimated at relatively low cost. With an appropriate communication, exemption, and appeal program, it can be made acceptable to the residents.

Given the wide tax base of the property tax, revenue is spread across the range of residents, ensuring a large revenue capacity for the local government. This tax is less sensitive to economic cycles and the economic state of the community than the business tax used by most local governments today. A unique property of property tax is that, when using properly upgraded appraisal techniques, revenue will increase as the value of properties increases year-to-year. Such growth will also be spurred by the gradual rescinding (over the next decade) of exemptions from the 1974 house-value tax. Thus, the growth of the number of taxpayers, and not the increasing of the burden on current taxpayers, will lead to the growth of revenue which can be expected from this type of taxation.

Tax should be fair and affordable. The value-based property tax, as it is proportionate to the level of wealth, usually places a larger burden on the well-off. As wealth (in this sense) better correlates with previous income than current income, it is recommended that exemption rules be introduced which prevent low-income groups from going into debt. These exemptions will further make the tax more acceptable to the residents.

Exemptions built into the tax system often lose sight of their purpose, or can compromise the transparency of the tax system while endangering a large part of revenues. For this reason it is worth undertaking a simulation study of the social and revenue effects of the new tax system in the preparatory phase. Such studies can predict the expected burden on various social groups given the level of necessary revenue and planned exemptions.

The introduction of a new tax is an unpopular move, and may meet strong residential resistance, which can endanger the success of collecting the tax. It is therefore essential to accompany the introduction of the tax with an appropriate communication strategy. The communication of the tax must conform with the political and technical preparation processes. We do not recommend a putsch-style introduction strategy. Such an approach might endanger the success of even the technically best-planned tax systems. In the framework of the communication strategy, space must be given to the following points:

- The reasons for introducing the tax: Why it is necessary? What the tax revenue will be spent on? What earlier revenue sources it will replace?
- The questions on fairness brought up by the residents: How will the new system will ensure that the rich pay more? What exemptions and tax reliefs will help those who are disproportionately burdened by the new tax?
- Ensuring that in the moment of introducing the tax the residents have a good handle on the technical details, and on their rights and responsibilities.

The introduction of a property tax can place a big burden on the tax departments of local governments, especially in those cases where the local government has not previously taxed its residents. Because of the large number of taxable items and the graduated levying process established by the Law on Taxation, the capacity of tax administration must be increased, meaning that the tax department, in terms of personnel and equipment, must be prepared in advance. A critical point of tax administration is the identification of taxpayers and the collection of data relevant to this task. The second critical point is the supervision of the tax declarations, which, given the number of taxpayers and the large quantity of data to be reviewed, becomes a practically permanent project. The third significant problem is the handling of appeals and complaints of unfairness. The management of this problem cannot be confined to administration alone: the problem must be anticipated during the planning of the tax and the development of the communication strategy.

Recommendations for Local Governments Intending to Introduce Value-Based Property Tax

This study will have accomplished its goal if, based on its recommendations, local governments adopt value-based taxation of structures, or if they put it on the agenda when deliberating alternatives for restructuring their tax systems.

The restructuring of the tax system is a strategic matter. As such it is very important that, before working out the technical details, the local assembly or local political leadership define the most important criteria for the program. Thus the level of expected revenue, and the tax burden and political priorities of defined exceptional social groups, all must be taken into consideration.

The establishment of the value of properties is a critical step in the introduction of the property tax. In our study we have shown how the use of calculated value can be a useful tool in the definition of property values. The method is inexpensive and acceptable, and simplifies annual corrections. The establishment of commercial value using this method can give rise to debate in individual cases. For this reason, calculated value must be defined such that the likelihood of successful appeals and the tax



payment decrease possibly arising from appeal be kept under control. In order for the appraisal method to be supported, the method should be fully visible to the public.

When planning the tax, emphasis must be put on the preliminary study of the effects of the tax. Only a fair and affordable tax will be acceptable to residents. These goals must be kept in mind when establishing tax rates and exemptions. Often, however, what appear to be reasonable exemptions do not produce their desired results, or are ineffective. They can often result in serious revenue decreases for the local government. To avoid such mistakes, the introduction of the tax must be preceded by simulation studies. Such simulations require data collection, and their preparation may take months. But the results they produce can save the political and fiscal costs of a poorly-planned tax.

The execution of the tax will be a great burden on the tax department of the local government, which must take on a new and larger role. The introduction and operation of the task can be made more efficient by increasing computer capacity, which is a one-time expense of introduction which will be made up for repeatedly over the years. In the long run the operation of the value-based property tax requires the development of a property registry which contains all the up-to-date data on properties.

The introduction of a new type of taxation comes with political risks for the local government. These political risks can easily lead to opposition to the tax, which can lead to the increase of arrears. This is why the introduction of the tax must be preceded by a social dialogue between residents and the local government. Such dialogue must explain the reasons for introducing the tax and what the tax will be used for, and must further prepare the residents for their new tax-related responsibilities. Dialogue creates an opportunity for local politicians to become more familiar with the expectations and needs of the residents. During the dialogue, at the beginning of the preparation process and after having defined the expectations of the new tax, the local government must plan its communication strategy. Communication must flow toward the local government apparatus, the decision-making politicians, and the residents. Messages to the groups will differ in timing and in emphasis.

There is one more thing we must bring to the attention of local governments. The introduction of a new tax is an extremely time-consuming process! The new tax (and the local government introducing it) can only be successful if preparations begin at least one year before its introduction.

Recommendations for Changing the Legal Framework

Although current regulations allow for the introduction of value-based property tax, there are several areas in which modification of the law would increase the ability to make use of this form of taxation.

Currently, the law on local taxes makes reference to the law on duties relating to the method of establishing property values. One of the goals of the law on duties is the individual establishment of the value of property on which it is mandatory to pay duties, and thus it can only be used for mass appraisal to establish tax base in a very complicated manner. Market value needs to be defined in such a way that calculated value is clearly allowed while maintaining maximum latitude for local governments and minimizing the potential number of appeals.²⁶ Of course calculated value must be proportionate to the commercial value of the property. The introduction of the category of calculated value must not decrease the autonomy of local governments, thus the design of the calculated value formula should be left to local governments, perhaps in a modification to the law. For smaller settlements a recommended regional average framework can be designed, which takes into account local factors, but which is in no way mandatory.

Given that prices among differing regions and settlements can diverge greatly, the formulation of the equation should be done locally. In those small settlements which lack such capacity (e.g., towns with under 5000 residents), self appraisal by residents²⁷ may be a solution, or the county Land, Budget, and Public Administration Information Office can formulate the equation. This would allow for the most local-level authority possible to undertake the task.

The use of calculated value would make it possible to avoid using the legally questionable commercial value category as a foundation of estimation.

A critical group in terms of the property tax is old people living in valuable properties. Countries with developed property tax systems have solved this problem by creating the inheritance tax category, by which they defer the tax obligation of the elderly resident. When the property is sold or inherited, the new owner is obligated to pay the inheritance tax. The introduction of this system would be beneficial in Hungary.

The practice of taxation is made more difficult for local governments by the fact that the regulations of the law on taxation conform primarily to the system of the central tax authorities. In several points it would be desirable to supplement the regulations which can be utilized by the local governments. For example, the institution of declaration obligation for collectable taxes must be reexamined.

As current practice has it that local taxes are to be paid twice annually (March 15 and September 15), and as these payments are often simultaneous with other fiscal

²⁶ This concept was reflected in the modification proposal for 1999 advanced by the Ministry of Finance but rejected by Parliament. We understand this is being reworked and will be reintroduced in the legislature without substantial changes.

²⁷ In the case of small settlements, the technical drawbacks of this method are not as serious as they are in larger cities, where the method is not recommended.



responsibilities of citizens (e.g., mandatory insurance), adjusting the law to make possible a more even distribution of tax payments would make it easier for local governments to increase their local tax revenues.

Access to relevant data is necessary for property taxation, and current law does not make this possible. Hence, we recommend that the duty departments and land offices be obligated to offer data to the tax departments of local governments.

Finally, the central government needs to, as a matter of policy, support increased autonomy in local income generation. In addition to the measures above to support the value-based property tax in particular, the government should support this shift more generally

For example, the government should seriously consider a reduction in central taxes, such as the PIT²⁸ or the VAT, which will in any case need to be reduced upon accession to the EU.

Of course the general increase in local tax revenue will increase inequality among regions, as the business tax has already demonstrated. For this reason the government needs to continue to work on improving methods for balancing differences among settlements. This issue requires an independent and detailed study, which is beyond the scope of this paper.

²⁸ For example, a deduction for local taxes paid.



APPENDIX

THE DETERMINATION OF PROPERTY VALUES

Appraisal Methods

A key question concerning the property tax is the choice of an appraisal method which meets the expectations of the local government, is within legal conditions, and is acceptable to the residents. By this we mean a technical solution which is easy to operate, requires a modest apparatus, and which can be repeated annually if necessary, thereby automatically sustaining the real value of tax revenues. It should be transparent and make necessary the fewest possible discretionary decisions in order that mass numbers of appeals may be avoided. It should be such that similar properties end up with similar assessed values. It should meet legal requirements, meaning that the value ascribed should equal the value “attainable through sale,” and for this reason the wide range of factors influencing value should be taken into account.

Let's approach the question from a wider perspective. The establishment of the value of a property depends on the definition of value. According to economics, in a perfect market the value of a good is that where the demand and supply meet. However, real estate cannot be seen as a perfect market, given that—even making just the most basic assumptions—the good is not homogenous, there are hardly two like properties in the market, and thus real estate cannot be considered a market of goods.

Basically there are three approaches to the establishment of property value. By the first, the value of a property is equal to the value of the territory plus the cost of building the structure anew minus the amortization of the structure (not, of course, in the accounting sense). This is the so called cost-based approach. By the second approach the property is seen as an investment, and its value is equal to that sum (in current Forints) which the owner earns from use while owning the property. The third approach is the so-called price comparison approach, and is also called market price appraisal. At first glance, the Hungarian legal definition resembles the third approach, but given that the other two approaches can also be seen as market value estimations, we must examine their utility as well. Among the three approaches the market price approach gives the most precise picture when an adequate number of transactions have taken place in the market, and thus by paying close enough attention we can establish the values of various kinds of properties. When this condition is not met then the other two methods provide us with very useful approaches.

Price Comparison Appraisal

The core of the appraisal based on market value, or the price comparison approach, is that the price of properties can be established by comparing the sale prices of similar properties. That is to say that there exists a market price by which properties not for sale can be appraised. In practice this means the following. As a starting point,

let's consider the sale prices of properties with parameters more or less similar to those of the property to be appraised, then let's correct the price by considering all those factors which differentiate the property to be assessed from the ones we used in the comparison. An infinite number of factors effects the price, and these might be physical parameters, e.g., that the property to be appraised has not one but two bathrooms, or that the roof is made of ceramic instead of slate, or its age may differ from that of the properties in the comparison, etc. Further, there exist nominal factors, the main one being the difference in the time of the appraisal of the property and the sale of the properties used for comparison. The choice of appropriate parameters is naturally not arbitrary, but parameters in individual appraisals significantly differ from those in mass appraisals. In individual appraisals all factors affecting the value of the property are taken into account by the appraisal expert, and thus the appraisal is precise. However, the value established is subjective. In mass appraisals the modifying factors must be standardized and their number must be limited. The results gained by the second technique can be determined with statistical precision, but it cannot be known whether unique factors, which can be significant for some properties, were left out because of their uniqueness. In this case the results can be imprecise for given properties, but the number of such cases can be estimated beforehand. Mass appraisals are more economical and result in more objective prices.

A problem arises when there have not been enough transactions, or in other words, when the market is slow. In this case we can locate a major market segment whose properties are in the same market we are studying. For example, if the number of transactions in Püspökladány is low for the past year, then, in the interest of comparison, we can utilize real estate data from similarly sized towns in the region, like Karcag or Kaba. When this is not a possibility, or when even this does not give enough registered examples for comparison, then the appraisal of property values must utilize the other two appraisal approaches.

Income-Based Appraisal

Commercial value is not unambiguous, given that it can be defined between a buyer and seller for only one day, and thus it is not an exact method for establishing value. In those countries where rental by individuals is common and a high percentage of properties are rented, e.g., France, the value of the property is calculated based on the income derived from using the property. Knowing the average rental rates for given types of properties, and then assuming that this rate can be kept for eternity, we can get the value derived from the utilization of the property. (Naturally this method can be used for unrented properties, as the value of the property is based on the rental fee saved, i.e., that which the owner does not have to pay to someone else.)

According to the (somewhat simplified) equation, should B_t represent the annual rental rate, i_t represent the income from properties of similar risk and investment, then the value of the property derived from use in current forints is:



$$\dot{E} = \sum_{t=1}^{\infty} \frac{B_t}{(1+i_t)^t} \approx \frac{B_1}{i_1}$$

Of course in this case we must use the rental rate of similar properties and the most likely rates of properties not for rent as a starting point, as the value of a property is not affected should the owner decide to rent it out under the market rate. The estimation of income from properties of similar risk is the factor to which the model is particularly sensitive, and it thus requires the help of experts.

The use of the equation given above is based on the assumption that rental agreements in the real estate market (or a segment of it) are common, and thus that income coming from the utilization of property is as predictable and gives non-arbitrary prices, as investments made in bonds. That is to say, the rental market is assumed to be effective. What are the advantages of this method? If a country should have real estate market segments with effective rental market segments, then the numerous and well-documented rental contracts give more information on certain types of properties and communities than does transaction data.

Is this method relevant in Hungary? Of course, we would not have described it in detail if we had thought it to be irrelevant. In Hungary the majority of offices are rented from property owners. Thus, for this market segment, more data is available through rental information than through sales information. When possible, then, this method results in more effective pricing than other methods. Is this appraisal method legally permissible? When property can be used long-term as office space and we stipulate that the owner rented the property to the renter offering the highest rate for the office, then this method lets us establish at what value the renter (as a potential buyer) would purchase the property from the owner in order that he/she may save the rental rate in the future. Hence, this is a realistic estimation of commercial value. Of course, the comments on differentiating individual appraisals from mass appraisals apply here too.

The Cost-Based Approach

The starting point of the third approach is that a well-informed buyer will not pay more for a property than what it would cost him/her to buy an empty plot and build a structure of similar quality him/herself. The owner, on the other hand, will not offer the property at a price lower than that which reflects all the direct and indirect costs and the realizable profit from all investments (which, in a competitive market, should develop automatically). Thus, this method also takes into consideration demand and supply in the real estate market when calculating market price.

The cost-based approach makes the estimation of the value of the plot, the cost of building anew the structure on the plot, and the devaluation of the property, all necessary. The general formula is as follows:

$$\begin{aligned} \text{Value} &= \text{Value of the plot} + \text{Value of the building} = \\ &= \text{Specific plot price} * \text{Area of the plot} + (\text{specific cost of the construction} * \text{area of the building}) \end{aligned}$$

The determination of the specific construction costs is made easier in some countries (where this method is common practice) by the availability of a handbook, where one can calculate the construction cost per square meter given varying parameters on building materials, size, age, etc.

This method gives the most precise approach for newly-constructed structures, where amortization is smallest and construction costs are most easily calculable. The method is useful for appraisal of properties where commercial or rental data is lacking, for example industrial and specific-use properties, where the other two methods cannot be utilized. Further, this method can be used simultaneously with the other two, because with mass appraisal techniques, if this method is used properly it results in consistent and stable data. Thus it can be used to verify the results gained from the use of other techniques.

The approaches described above differ in their methods and philosophies, but they do not tell us how appraisal may be made technically feasible. Thus, below, we deal with various appraisal techniques. In the ideal case we would combine these techniques. For example, we would use the results of one technique as our base, and compare them to the results of another technique, and when there is large disparity, we would apply an individual appraisal.

Self-Appraisal

One of the most trivial appraisal techniques is self-appraisal, where the owner is asked to estimate the value of the property. While this method has numerous advantages, its shortcomings do not allow it to be an approach used singularly.

This is the cheapest possible approach, given that it does not require an appraisal staff, is easily executable, and, perhaps its biggest advantage, it is in the eyes of the residents the most acceptable approach and thus it carries the lowest political risk, given that no one can appeal their own miscalculations.

On the other hand this technique results in the most imprecise estimations, and in the case of similar properties we can expect a large scattering of results. The value of property is inconsistent and—even though no one will appeal—is possibly the least equitable approach, as it may result in one taxpayer paying more than a neighbor in a like flat, where all the characteristics of the flats, with the exception of the appraised



value, are exactly the same. Of course the local government will encounter the moral hazard problem as well, given that the taxpayer—knowing full well the relation of the appraisal to the taxation rate—will naturally underestimate the value of the property.

To avoid or minimize these problems the local government must reserve the right to ask for expert appraisals of individual properties in suspicious cases. This has two positive effects. First, it can correct purposeful underestimation. Second, given that in this case the losing party must pay the expense of the expert appraisal, it can serve as a counter-motivation to exaggerated underestimation. But this significantly increases the costs of collecting the tax, because the costs of control must be covered by the local government. But given that the scattering of value is unavoidable, it is recommended that local governments choosing this technique define value categories, as this eliminates the problem of like properties being assessed differing values. It is desirable to have a relatively straightforward estimation method to be used for control purposes, for example the mass appraisal technique (discussed below).

There remains another problem which keeps us from recommending this technique. Generally lower-value properties have a lower rate of underestimation than do properties of high value, meaning that equitable burden-sharing is skewed to disfavor poor families.

Local governments of small settlements can significantly reduce problems arising from self-appraisal. In a small environment, where everyone is known by everyone else, appraisals will be more realistic, even with this method. These facts, the advantages of this method (low-cost, simplicity, less need for specialized expertise), along with the difficulties of using other techniques in small settlements, are serious arguments for the use of self-appraisal in such environments (i.e., those with a maximum population of a few thousand, or very small cities.)

Expert Estimations

The appraisal of property values is also possible through individual assessments. This method is the most precise, and in terms of the trust of the residents, it is one of the most accepted methods of appraisal. But beside such advantages, there are serious drawbacks. The most significant of these drawbacks is expense. In per-dwelling terms, this expense, compared to other methods, increases with the number of properties to be assessed. Thus, in bigger cities this procedure is considerably more expensive than others. However, these costs are not fixed. International practice shows that when real estate agencies compete with one another for this work, then the expenses to the local government decrease significantly. Of course this depends on the number of real estate agencies in the given market. There exists then a visible change, by which in bigger cities this method is more expensive compared to others, but given the presence of numerous organizations dealing with real estate, the cost per dwelling can be quickly decreased.

Another problem with this method is that it consumes the most time. This way the appraisals must be begun months before the introduction of the tax. As such, the preparation for the introduction of the tax can be more than one year. Of course this time can be shortened by using several real estate agencies. Because of the time it consumes, this method cannot be repeated annually. However, the indexing of values based on the results of such appraisal is most acceptable.

The third problem is the subjectivity of the appraisal. It is likely that the appraisals of the two best-intended appraisers will never be the same, and as such the value ascribed will always be contestable. Such subjectivity can lead to dissatisfaction with appraisals and in some cases masses of appeals.

The use of this method in Hungary is slowed by the fact that in most cases, the real estate market in provincial cities is slow, and thus there is a limited number of real estate agencies on which to rely. This makes the suggestions for increasing effectiveness largely void. Further, in small cities where there is only one real estate agency, the possibility of corruption in individual assessments is increased.

Mass Appraisal

The estimations of experts provide the best approximations of real market value. However, it is questionable whether local governments can afford the time and expense associated with the method. Clearly the value of properties is influenced by numerous but finite factors. These can be divided into two groups: 1) the parameters of the location of the property—basically the parameters of the plot (e.g., neighborhood, level, positioning, etc.); and 2) the physical characteristics of the structure (e.g., the age of the dwelling, amenities, construction, etc.). Expert appraisals are founded on the consideration of these factors and implicitly, such appraisals are based on the following method. The real estate expert corrects the average price per square meter of the neighborhood with the special characteristics which influence the value of the property, and then calculated price is multiplied by the number of square meters making up the surface area. The knowledge of prices of property types in the neighborhood, and the practice of weighing the factors modifying value, ensure the expert. Sometimes though, specific factors modifying value cannot be measured precisely, they are ascribed specific values. The local government can achieve its goals if it can define and ascribe weight to the parameters which influence value. Statistical analysis is a tool which can help solve the problem.

A representative sample of the stock of properties in the city serves as the base for the calculation of an equation, whose general form is presented in Table 5. The calculation and interpretation of the equation requires not only a statistician, but a real estate expert as well. The job of the local government is to collect the information required for the equation in the tax return phase.



The value calculated through the use of the equation will only on average match the appraisals of experts. This is so for two reasons. First, every property has special and unique characteristics which the equation does not take into account, for example, the value of a property declines if it is situated right next door to a bar. Second, different appraisal experts often differ in their estimations on single properties, so we cannot expect results from two different methods to match.

There are two ways to alleviate the first problem. First, as special factors are possible and can be neglected in the equation, one option is to correct over-estimations by using the lower market values than those calculated through the equation, for example using 90 percent of the calculated value. The advantage of this is that using a discount (10 percent in this case) in the calculation of property market values means that appeals will only arise in extreme cases. The other approach is an appropriate appeal process, where, for example, the local government allows appeals where expert appraisals are attached, or where the property has been sold in the previous one year. Given that expert appraisals are not free, only those who have found high discrepancies between the calculated value and the market value are likely to appeal.

The second problem is not really a problem, given that if expert appraisals are consistent, then calculated values will reflect the consensus of appraisers, and thus the discrepancies that occur will not be significant.

The big advantage of the method is that it is transparent and easily understood. It visibly appraises valuable property at a higher rate, cancels the need for individual (or compromised) assessments, is thus objective, and ascribes similar values to similar properties. Should the communication strategy make the appraisal technique clear to the residents, the trust between the local government and residents is likely to increase.

Annual indexing can be managed through two methods. First, given values can be corrected yearly with a pre-established rate (e.g., the rate of inflation), just like with other methods. The second way, which is a unique advantage of this method, is that with the collection of a sample every year, the average yearly value change in the city can be used to make corrections more objective from year-to-year. (With the oncoming accession to the EU, it is expected that the increase in the value of property will surpass the inflation rate, thus the second approach to indexing will result in higher revenue growth.) Naturally this method assumes the relative stability of factors modifying value, an assumption which (as is the case with the other methods) being untrue, leads us to recommend revisions to the appraisal equation at regular intervals, e.g., every five years. If this is done the second method of indexing will result in smaller increases when re-appraising properties.

Mixed Methods

Numerous factors may arise which for local governments raise doubts concerning the feasibility of the introduction of value-based property tax. Perhaps there are political objections, where the residents have already accepted a tax based on floor-space and the political risks of a radical change are higher than those associated with a minor correction. Or there may be difficulties regarding technical feasibility: capacity may be too small for introduction. Still other factors may lead to further objections. At the same time it is likely that, agreeing with the principle of burdens being proportional to wealth, change might be desired that would see floor-space based tax move toward a system more based on market value. There then remains a further option.

As seen above, a very important factor in the value of a structure is its location. Most all cities have their richer neighborhoods, and sometimes the location of property is the most important factor influencing value, or sometimes this factor is a good predictor of the physical condition of property. For example, a housing project made up of apartment buildings will likely have numerous properties with similar physical parameters, and the physical parameters will be predictable, in turn, by determining the location of the property (within the housing project, for example). It is likely that the developmental history of a city resulted in homogeneous neighborhoods, for example in cities built in this century's socialist period. In these cases the local government, through the use of a simple technique, can imitate the equity advantages of the value-based tax within the framework of a floor-space tax.

The method is essentially as follows: the local government established taxation zones, where tax is levied based on differentiated rates per square meter. In this case the local government takes into consideration only one factor affecting value, that being location. In the given neighborhoods the local government annually compares the sale prices with the tax rates it levies. In this way rates per square meter in elite neighborhoods might be twice as high as those in outlying dilapidated areas, should the sales data establish that there is a similar price difference between the two areas.

This method has three very dangerous problems. First, that local government which wishes to keep its real revenue must raise the tax rates annually. This is limited by law, and political risk must be incurred every year. Second, such a tax construction can seriously effect the development of a city, as it can segregate neighborhoods, allowing some to further prosper and others to further decline. Third, as location is the only factor taken into consideration, the system will only be acceptable to residents accompanied with an expansive exemption system, which can soften revenue and make the tax largely ineffective.

Given the above, this technique is recommended only in those cities where there exist well-defined and homogeneous neighborhoods, both in terms of property value and the social groups residing in the neighborhoods.



Although Hungarian law does not make its use possible, some argue for the introduction of the English band system. In our opinion, though, its several advantages are dwarfed by its disadvantages. What is the English model like? Homes are put into value categories based on their characteristics (e.g., a given home might fall into the category of having a value between 1.5 and 2.5 million HUF), and the local government establishes the tax level for given categories. Clearly the bypassing of precise individual property appraisals is an advantage, and thus a more coarse and simple appraisal system can be enough to introduce the tax. As it does not give precise values—it only puts properties in general intervals—only those who have their properties assessed lower than the bottom of their band will take offense to the appraisal, and they will not be likely to appeal. Despite its advantages, the system does have disadvantages. First, the appraisal method can lead to inequities within bands. For example, in the band defined above, the owner of a 1.5 million HUF property will pay the same amount of tax as that of a 2.5 million HUF property. It is particularly unfair that as a rule the top band is open upwards, meaning the most expensive properties are taxed generally less. While this decreases the number of appeals, the amount that can be won in appeal is higher in this system, and hence those who are at the bottom of their bands will often appeal, and the revenue loss from appeals will be higher than in a system with a continuous value scale. The real problem is caused when the local government establishes the bands²⁹, in which case the width of the band is determined through political compromise (as opposed to professionalism), while central definition of bands would decrease local government autonomy.

REGULATION OF ASSESSMENT

The relevant provisions of Act XCIII./1990 on levies state the following:

Details from Act XCIII./1990 on levies

Reporting and Establishment of the Value used as the Basis for the Levy

69. § The party obliged to pay the levy is responsible for declaring the market value when reporting on the legal transactions or estate, when he/she is responsible for the liability. In other cases the market value should be reported by the deadline set by the levy office in its notice.

70. § (1) If the parties failed to state or report the market value or if the market value stated or reported differs from the market value the levy office considers to be correct, should the levy office shall discover the market value was established by court decision, such value cannot be revised by the levy office.

(2) The levy office shall establish the market value by site inspection and comparative value data, and when knowing the statement by the person obliged to pay the levy—if necessary with the participation of external expert.

(3) Out of the comparative data the levy office shall consider the following—together with other value-

²⁹ In the UK a central appraisal office defines the width of the value bands, and local governments are limited to ascribing tax levels to these bands.

related considerations—for the purposes of establishing the market value:

a) the determinants of value in trade in real estates encompassing minimum 2 years in the case of transfer of property in relation to the settlement, or in the case of larger settlements in relation to a smaller district which can be separated from the settlement as a whole, or in case of areas outside the limits of the settlement an economically inter-connected region, including especially the increasing or decreasing turnover in properties, or the total absence of trade in real estates, the relevant or different value data and the data on the purchase of property closest to the given property geographically and in time which can be considered for the establishment of market value. Primarily properties used for the same purpose should be compared. If there is no property in the settlement which can be compared with the given property, for the establishment of the market value, the purchase price of similar properties in settlements in the same region with similar features can also be taken into consideration;

Interpretation provisions:

§ 102. (1) e) market value: the value expressed in money, which can be received as sale price for the asset item based on its condition at the time of the origination of the duty, without taking into account the debts on the assets or the rental right on real properties which ceases to exist for the party acquiring the asset in the case of alienation.

DATA REGISTRATION TECHNIQUES

The specific character of the simulation model to be applied by the local governments is determined by the type of the new tax, the planned revenues, the available resources of the local government and the priorities of local politics. Individual simulation procedures may be best distinguished by their levels of reliability, depth of detail, and by the expenses they incur. In this section, the following four methods are described: 1) Simple statistical estimates; 2) Estimates based on data from duty offices and guardianship authorities; 3) Small sample property surveys; and 4) Community polls.

Simple Statistical Estimate

Applicable if local needs do not require data of specific detail, or if in a definite, early phase of the introduction of a new tax fairly good results can be expected from estimates based on the most essential data of statistics. The great advantage of this method is simplicity and quick results, which on the other hand harbor imminent risks as well.

When drawing up an estimate, aggregate data on the entire community are seldom sufficient, thus break-down figures are also needed. Likewise, if a property tax is intended to be imposed based on value instead of area, the average property value will have to be established. In these cases experts' estimates will have to substitute data that are not at hand, which may allow for very serious instances of imprecision. On one occasion for instance, experts familiar with the community assessed the aggregate area of homes to be 260.000 m², where more accurate procedures indicated a total area of 360-370.000 m². As a result, expected actual tax revenues may be two to three times higher than those calculated on the estimate (15.8 million HUF instead of 5.4 million,



and 87.7 million HUF instead of 42.3 million). Therefore, estimates of this sort require increased caution and the results of alternative assessments, if there are any, ought to be consulted.

Estimate Based on Data from Duty Offices

The databases of municipal and county duty offices and guardianship authorities, containing substantial stocks of information on property, are accessible, including a lot of partial figures and details which, supplemented by statistical data on the entire community, can render estimates more accurate.

These databases contain available data on the size, value, level of comfort, and eventually the current condition of apartments. The projection of these data on the whole community yields an estimate on exemptions, for instance, far more reliable than a simple statistical estimate would. The difficulty underlying this method is that the data do not cover the entire stock of apartments of the community, but rather focus on specific segments. It may be assumed that apartments involved in procedures of the guardianship authorities or in proceedings of inheritance are of substantially lower quality than the average, whereas those subject to market transactions are somewhat better than the bulk. Thus, results may be distorted to an unpredictable extent.

Such data, therefore, may be very useful in fulfilling medium level information demands by offering a basis for estimation models of low complexity. Furthermore, their acquisition is easy and probably inexpensive. When using such data to compute results, the fact that the information is highly prone to distortions and calculated revenues are unlikely to be in line with the amount actually collected needs to be taken into account.

Small Sample Survey by Professionals

Where the resource requirements of the above-discussed methods are practically negligible, in the two other procedures the acquisition of data may cost anything from 100.000 HUF to even 1.5 to 2 million HUF. Among them the small sample survey is the least expensive, requiring a budget of a few hundred thousand Forints. A possible form of the property survey is to define, ideally, 7 to 15 zones within the territory of the community. It is important to set up zones that are as homogeneous as possible, in terms of apartments and tenants. Within each zone a sample unit is to be identified, including 20-50 apartments, which in turn will be surveyed on the basis of a questionnaire of no more than one page. (see appendix). In the formulation of the questionnaire or data sheet, two main questions need to be taken into consideration. First, what is the minimum scope of information required for the examination of the revenues, exemptions etc. related to the tax to be levied? Second, what information is available without polling members of the community? The success of the survey can be best guaranteed if the data collection is conducted by local experts/professionals dealing with real estate assessment. As a consequence, relatively precise data can be

gathered through this procedure. The only barriers can be due to the lack of extension and the difficulty of involving local residents. Hence, this examination—beside implying a relatively greater financial sacrifice—makes it possible for the local government to acquire all the data necessary for the introduction of levying tax upon buildings, as far as real estate is concerned. However, missing will be virtually all those pieces of information which could establish a reliable ground for determining the communicational strategy (for finding out to what extent the local community is solvent, to what extent they are inclined to make financial sacrifices, and for outlining the measures to be taken for introducing levying). The validity of this method rests on the zone-system and the proper selection of blocks and flats. Its use is suggested primarily for smaller settlements: in the case of a city as large as Budapest it could be applied only with major difficulties.

Surveying the Residents

To acquire the data necessary for simulating the introduction of local taxation, the most efficient but most expensive method is—with all likelihood—data collection among the residents. Depending on the magnitude of the sample taken, such an examination may approach a cost of HUF 1-1.5 million. Irrespective of the extension of a certain settlement, at least 500 people need to be questioned to achieve statistical significance. Inasmuch as applicable information would also be needed concerning the inner zones within a settlement, in the course of sample-taking attention must be paid to the fact that at least 50 people should be questioned within each particular zone. Surveying the residents must, by all means, be conducted by professionals who, in the course of designing the questionnaire, might at the same time serve as the experts from the local government preparing to levy the local tax.

Surveying the local residents is the means through which the most thorough information possible can be gathered for the sake of preparing local levying. Where such surveys can be conducted, it is highly recommended to reinforce findings by incorporating data collected through other methods before making the final decisions. Thus, by surveying the residents, it is not only the data related to real estates which can be made accessible, but also information can be acquired in connection with affordability (impact exerted upon certain social layers, calculating the ratio between tax and income), paying inclination (arrears to be expected), and communication strategies (purposes acknowledged/appreciated by the residents), etc.

At the same time, there arises a very important problem in connection with the information gathered through the residential survey. The information acquired in the course of surveying the residents are actually opinions; even the answers given to the simplest questions can reflect the momentary psychological condition of the subjects. Given the low popularity of the topic, this can be a serious distortion. Accordingly, the surveyor can introduce some questions which gauge the precision of the responses, and can judge the subjectivity/objectivity of certain responses (given his/her



professional experience in conducting surveys). In this case, however, one of the most important questions can be answered only by the survey subject. In this respect, it is the 'small sample survey' that can render the most precise information where real estate has been assessed by professionals. In order to redress this problem, in strict compliance with private rights, a professional real estate appraiser can be involved.

Conclusions

For a local government that stands before introducing new local taxation, it is expedient to plan the whole preparatory process. In the first phase of the procedure, it is wise to determine the prospective proceeds based on less secure and simple data by employing an estimation process providing less information. Afterward, toward the end of the procedure when there remain fewer strategic alternatives, a more complicated and expensive—but at the same time more extensive problem-analysis technique—is recommended.

The data presented in this study is the result of statistical analysis. The data quoted, unless otherwise indicated, derives residential data collection, as this method is the proper way to ensure the most extensive overview of the problem.³⁰

³⁰ In March and April of 1999, in six towns (Nagykanizsa, Orosháza, Püspökladány, Szentes, Szolnok, Tatabánya) a representative survey was carried out by questioning 400-400 persons. One part of the questions was lifted into the questionnaire with the purpose of the simulation examination in connection with levying the local tax; these questions can be found in the Appendix.

DATA SHEET OF SMALL SAMPLE SURVEY

Serial number: address: zone:

1. Floor area: m² 2. Number of rooms:

3. Type of property: (Mark the most applicable)
 a. family cottage
 b. attached houses
 c. condominium

if condominium:
 3.1. Number of flats units
 3.2. Common Area of joint premises: m²

3.1. The size of plot belonging to the property m²

4. The number of persons living in the property: persons

5. Ownership structure of the domicile: (Mark the most appropriate)
 a. local government
 b. resident-owned
 c. rented from private owner
 d. econ.org., foundation, etc.
 (If the flat is owned and occupied by economic organization, foundation, or was established by it, state b.)

d. without comfort
 e. fit for temporary use only

6. The state of the dwelling

1	2	3	4	5
very bad				very good

7. Approach to the flat: (Mark the most appropriate)
 a. paved road
 b. dirt road
 c. others.....

8. Number of Owners: head

9. Utilities:
 10.4. electric energy yes / no
 10.1. water supply yes / no
 10.2. sewage canal yes / no
 10.3. gas pipe line yes / no
 10.4. linked by telephone yes / no

10. The level of comfort of the flat (Mark the applying one)
 a. full comfort
 b. full comfort, but no central heating
 c. semi-comfort

11. The value of the flat (1000 HUF)

12. Special conditions to be considered ...

... factors increasing the value	... factors decreasing the value

13. Other buildings belonging to the property (only those with size bigger than 10 m2)

Name	floor space	estimated value (1000 HUF)
a.	<input type="text"/> <input type="text"/> m ²	<input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/>
b.	<input type="text"/> <input type="text"/> m ²	<input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/>
c.	<input type="text"/> <input type="text"/> m ²	<input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/>
d.	<input type="text"/> <input type="text"/> m ²	<input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/>

14. Income position (only estimation, must not be asked. Mark the appropriate one)
 a. very wealthy (richly furnished flat, with luxury items, e.g. several cars)
 b. of medium wealth (comparatively well to do family, with maximum 1-2 luxury items)
 c. average financial status (well maintained aging furnishing, no unemployed in the family)
 d. in bad position (low income, they are complaining, find it hard to pay the bills)
 e. very poor financial conditions (hardly any furnishing, the building is in a very poor state)



SUGGESTED QUESTIONS FOR THE SIMULATION OF LOCAL TAXES ON THE SAMPLE OF RESIDENTS

- 1. Did you complain during the last twelve months against some service, procedure of the local government or some impolite officer?**
 - 1 – Yes
 - 2 – No
 - 0 – Does not know
 - X – No answer

- 2. If yes , in what matter?**
 - 1 – Social
 - 2 – Housing
 - 3 – Tax
 - 4 – The operation of the town (road, pavement, park, water, sewage, etc.)
 - 5 – Construction
 - 6 – Custodian
 - 7 – Education
 - 8 – Other

- 3. To whom did you turn with your complaint?**
 - 1 – Officer of the competent department
 - 2 – Head of the competent department
 - 3 – Client service
 - 4 – Competent institution
 - 5 – Mayor
 - 6 – Notary
 - 7 – Local government deputy
 - 8 – Office employee you knew
 - 0 – Does not know
 - X – No answer

- 4. How did you complain?**
 - 1 – Personally
 - 2 – By telephone
 - 3 – By mail
 - 4 – On the toll-free number
 - 5 – Other

- 5. Were you in general satisfied with the way you were received at the local government?**
 - 1 – Yes
 - 2 – No
 - 0 – Does not know

X – No answer

6. If you were not satisfied, select from the statements on the card! I was not content because

- 1 – I never got answer to my question or did not receive the service I asked for
- 2 – Because the answer received was not suitable or exact
- 4 – Because I had to wait too long and had to ask the officer again and again
- 8 – Because I had to run around a great deal , there was too much bureaucracy
- 16 – Because the officers were impolite and negative
- 32 – Because of some other reason
- 0 – Does not know
- X – No answer

7. Did it happen last year that you wanted to submit a complaint to the local government, but then decided against it?

- 1 – Yes
- 2 – No
- 0 – Does not know
- X – No answer

8. Name maximum three such cases!

- 1 – There is answer to be interpreted
- 0 – Does not know
- X – No answer

9. Why did you decide not to make a complaint? Select from the statements on the card!

- 1 – I thought they would not help
- 2 – I expected, or I experienced that I would have to wait long
- 4 – I thought that the local government would already know about the problem or that someone else already reported it
- 8 – The procedure looked long and was impossible to understand
- 16 – I did not know where to turn
- 32 – I could not get to the competent officer, responsible person
- 64 – The situation was unpleasant, humiliating
- 128 – Other
- 0 – Does not know
- X – No answer

10. Did you attend a public meeting during the past 12 months?

- 1 – Yes
- 2 – No
- 3 – There was no public meeting
- 0 – Does not know



X – No answer

11. Did you see a local television program summary on the meeting of the local assembly?

1 – Yes

2 – No

3 – The local TV program cannot be seen

0 – Does not know

X – No answer

12. How well-informed do you think you are in the following matters: fully, mostly, medium. Slightly, not at all?

1 – Local government decisions

2 – Local government issues

13. If you are medium- or well-informed, where do you get information on the Office of the Mayor or of the Local Government?

1 – Local paper/s/

2 – County papers

3 – Local TV

4 – Local radio

5 – Advertisements

6 – Personally at the local assembly meetings

7 – Others

14. What do you think is the biggest problem of the town?

1 – Drop in resources

2 – The operation of the institutional system

3 – Bad drainage system

4 – Care of the elderly

5 – Housing problems

6 – Problems of young people

7 – Gradual aging

8 – Emigration from the town

9 – Canalization

10 – Public safety

11 – Extension of the welfare system

12 – Not enough jobs

13 – Unemployment

14 – Approach to the town

15 – Living standards

16 – The standard of services

17 – The standard of public cleanliness

18 – The leadership of the town is not efficient

- 19 – Lack of information
- 20 – The citizens are not involved in the preparation of decisions
- 21 – People do not care

15. How satisfied are you with the following services supplied by the local government? Give marks to these services the way school-marks are given!

- 1 – Education
- 2 – Health care
- 3 – Hygiene of public areas
- 4 – Welfare services
- 5 – Public security
- 6 – Garbage removal

16. Put into the sequence of importance the following local government operation areas!

- 1 – Education
- 2 – Health care
- 3 – Hygiene of public areas
- 4 – Welfare supply
- 5 – Public security
- 6 – Garbage removal

17. Are you monitoring the local government management?

- 1 – Yes
- 2 – No
- 0 – Does not know
- X – No answer

18. Did you pay local tax during the past 12 months

- 1 – Yes
- 2 – No
- 3 – Did not have to
- 0 – Does not know
- X – No answer

19. If you were to decide, which are the areas you would spend most on from local taxes? Select three from the areas listed on the card. You can also select a service currently not supplied by the local government!

- 1 – Kindergarten care
- 2 – General school education
- 3 – Secondary education
- 4 – Higher education
- 5 – Basic music and art education
- 6 – Supply of drinking water



- 7 – Public lighting
- 8 – Maintenance of public roads
- 9 – Operation of public cemetery
- 10 – Drainage of flood
- 11 – Maintenance of park
- 12 – Operation of bath
- 13 – Maintenance of rented flat
- 14 – The utilization of flat and non-housing premises
- 15 – Public hygiene related tasks
- 16 – Operation of garbage depository
- 17 – Public transport
- 18 – Drainage of sewage
- 19 – Kindergarten education
- 20 – Basic health care
- 21 – Hospital maintenance
- 22 – Home for the elderly
- 23 – Club for the elderly
- 24 – Subsidy to child care
- 25 – Subsidy to the rearing of children
- 26 – Subsidy to the establishment of home
- 27 – Contribution to housing rent
- 28 – Contribution to income
- 29 – Regular welfare
- 30 – Nursing fee
- 31 – Subsidy to funeral
- 32 – Public funeral
- 33 – Public health care
- 34 – Catering
- 35 – Home care
- 36 – Daytime social care
- 37 – Subsidy to the homeless
- 38 – Sports tasks
- 39 – Archives
- 40 – Operation of theater
- 41 – Operation of cultural center
- 42 – Fire brigade
- 43 – Operation of library
- 44 – Operation of museum
- 0 – Does not know
- X – No answer

20. Would you be ready to contribute more to those objectives?

- 1 – To those objectives, yes
- 2 – Only to concrete programs

- 3 – By no means
0 – Does not know
X – No answer

Personal Data

21. Data on the interviewed person and family members living in the same household Codes to question A1!

Family status	Education	Family status	Economic status
1. The interviewed person	1. Less than 8 classes of general school	1. Unmarried.	1. Active earner – employee
2. Spouse	2. 8 classes of general school		2. Active earner – self-employed
3. Child	3. apprentice school, vocational training school, specialized school	2. Married	3. Retired – working
4. Parent/mother/father-in-law		3. Widow	4. Retired – does not work
5. Grandchild	4. completed secondary school	4. Divorced	5. On child care allowance
6. Brother/sister/brother-in-law/sister-in-law	5. college, university	5. Companion for life	6. Unemployed
7. Other relative			7. Day-time student
8. Not relative			

22. If entrepreneur, the legal form of enterprise?

- 1 – Self-employed
2 – Partnership
3 – Non-profit company
4 – Ltd.
5 – Share company
6 – Not entrepreneur
0 – Does not know
X – No answer

23. In what industry does the enterprise operate? You can mark more than one!

- 1 – Industry
2 – Agriculture
4 – Trade
8 – Service
16 – Other
0 – Does not know
X – No answer

24. Do you pay industry tax?

- 1 – Yes



- 2 – No
- 0 – Does not know
- X – No answer

25. Does the enterprise own...? Specify on the attached map.

- 1 – Workshop
- 2 – Warehouse
- 3 – Commercial unit
- 4 – Empty plotFt
- 0 – Does not know
- X – No answer

26. What is the total monthly income of the household?

.....Ft

27. Is the income sufficient to cover monthly expenditures?

- 1 – Yes , they can save monthly
- 2 – Yes, in some months we can save
- 3 – The income more or less covers the expenditures
- 4 – At the end of the month we have generally difficulties
- 5 – In most cases the salary does not reach up to the end of the month
- 0 – Does not know
- X – No answer

28. Did it happen to you during the last one year that you could not pay your bills?

- 1 – Yes
- 2 – No
- 0 – Does not know
- X – No answer

29. Are you in more than three months in arrears...?

- 1 – With the payment of local tax
- 2 – With fees (housing overhead costs)

30. Were you in the course of the last year in over three-month arrears?

- 1 – With the payment of local tax
- 2 – With fees (housing overhead costs)

31. If you were or are, what was (is) the reason?

- 1 – I did not have the time to pay
- 2 – It was incorrectly calculated and I already appealed
- 3 – I do not agree with the levy, with its use
- 4 – I cannot pay

5 – Others

32. How much does your household pay in the average per month?

- 1 – On housing utilities
- 2 – On food and other daily necessities
- 3 – On clothing (the monthly sum of the annual expenditure)
- 4 – On household durables (the monthly sum of the annual expenditure)

33. The type of the housing property

- 1 – Family cottage
- 2 – Flat in condominium
- 3 – Attached houses
- 0 – Does not know
- X – No answer

34. In the case of condominium, the number of flats in the building (in case of attached houses, if more than one flat in each)

- 0 – Does not know
- X – No answer

35. How many square meters form the useful space of the flat?

-m² (in case of from - to answer the middle should be the code)
- 0 – Does not know
- X – No answer

36. How many square m. is the plot belonging to the house (also for attached houses)

-m² (in case of from - to answer the middle should be the code)
- 0 – Does not know
- X – No answer

37. Are you in the flat...?

- 1 – Owner
- 2 – Tenant
- 0 – Does not know
- X – No answer

38. If tenant, who owns the property?

- 1 – Private person
- 2 – Company
- 3 – Local government
- 4 – Other
- 0 – Does not know
- X – No answer



39. The number of rooms in the flat?

- 0 – Does not know
- X – No answer

40. The number of half rooms in the flat?

- 0 – Does not know
- X – No answer

41. Is there in the flat a separate...?

- 1 – Bathroom
- 2 – Kitchen

42. Is there gas supplied to the flat by pipeline?

- 1 – Yes
- 2 – No
- 0 – Does not know
- X – No answer

43. Is the flat/house linked to public canalization system?

- 1 – Yes
- 2 – No
- 0 – Does not know
- X – No answer

44. The heating of the flat

- 1 – Central/district heating
- 2 – Central heating of the flat separately
- 3 – Modern specific heating (gas, oil)
- 4 – Traditional specific heating (coal, timber)
- 0 – Does not know
- X – No answer

45. How would you classify the status of the flat?

Give school marks 1 – 2 – 3 – 4 – 5

0 – Does not know

X – No answer

46. Did you renovate the flat during the past five years?

1 – Yes

2 – No

0 – Does not know

X – No answer

47. In what year?

19.....

0 – Does not know

X – No answer

48. In what value?

..... thousand HUF

0 – Does not know

X – No answer

49. What did rehabilitation cover?

1 – Comprehensive reconstruction

2 – Minor modernization

3 – Minor painting, rehabilitation

0 – Does not know

X – No answer

50. How well supplied is the flat with utilities?

1 – Full comfort

2 – Comfort

3 – Semi-comfort

4 – Without utilities

5 – Fit for temporary living only

0 – Does not know

X – No answer

51. What price could you get for the property?

.....thousand HUF

0 – Does not know

X – No answer

52. Do you have other property also? Mark it on the attached map on the applying zone.



Type of property	No	Yes	0 X			Size (m ²)	Value (1000 HUF)	Zone code
1. Garage	1	2	0 X		292	297	302	307
2. Second home	1	2	0 X		293	298	303	308
3. Summer cottage	1	2	0 X		294	299	304	309
4. Plot	1	2	0 X		295	300	305	310
5. Other	1	2	0 X		296	301	306	311

53. Do you have in your household...?

- 1 – Car
- 2 – Color TV set
- 3 – Computer
- 4 – Video recorder
- 5 – Video camera
- 6 – Mobile telephone
- 7 – Dishwasher

54. How do you foresee the present and the future?

- 1 – Of the country
- 2 – The settlement
- 3 – Your own family

SAMPLE QUESTIONS AND ANSWERS FOR THE PROPERTY TAX COMMUNICATION STRATEGY

Ability to Pay

Question: Isn't the Hungarian population already overburdened with taxes, and thus don't you think they will be unable to pay a new tax?

Answer: International comparative data shows that the populations of several countries have higher burden burdens than do Hungarian taxpayers. Canadian and Swedish taxpayers give up a much higher proportion of their incomes as tax than do Hungarians. The tax rate depends on the expectations citizens have of the quality of services. For example, in the United States, citizens prefer to receive fewer benefits , as they do not wish to pay higher taxes. In Europe citizens are more willing to pay higher taxes for better quality services. At the same time it is important that all citizens feel that they contribute to local expenditures, i.e., that tax is 'equitable': those who have more pay more.

Question: Perhaps it is true that the rate of property tax, as a proportion of local government revenue, is higher in western countries, but do western local governments have the right to introduce other forms of taxation?

Answer: Yes, western local governments have the right to introduce other types of taxes. However, the property tax is especially popular because it is equitable and keeps pace with economic changes, and because the tax base is not mobile. In addition, leaders of local governments in the west are aware that there is a limit to the total tax rate that citizens are willing to pay. When the level of taxation approaches this limit, citizens begin to oppose taxes and look for ways to avoid paying them.

Question: Do you think that personal income tax and/or other central taxes should be decreased when property tax is introduced?

Answer: In some countries local level taxes are subtracted from personal income tax. This may be an adequate solution for Hungary, but for this to happen a dialogue and analysis on the effects of local and central taxes must take place. [do you really want to emphasize this?] Beyond this, the central government may be considering the lowering of different taxes, e.g., Value Added Tax, concurrent with joining the EU.

Transparency, Simplicity

Question: Don't you think that people will try and avoid paying this tax, and that the rich will be best able to avoid paying? People will claim that their old or ill relatives are the property owners, and gain the privilege of exemptions.

Answer: One of the important characteristics of value-based property tax is that the taxable items cannot be hidden, hence, otherwise non-taxed income becomes taxable. In theory there are of course always ways to avoid paying the tax. But should the taxation rules—including the appeal and punishment processes—be straightforward, understandable and accessible, and should they be simple to use, such cases will be rare.

Question: Aren't you afraid that the new tax will fail due to the opposition of citizens?

Answer: If citizens understand what the tax will finance, and if they understand that the tax is equitable, then there is a greater chance that they will do what it takes to meet the tax requirements.

The goal of local taxes is to help local governments gather the resources for sustaining local services. It is advisable for local populations to participate in the financing of the services they use.

Appraisal of Properties



Question: One of the problems is assessment . Who will measure the value of properties, and on what grounds? Won't the rapid changes in apartment and house prices mean that re-appraisal will have to be done often? Doesn't this mean that local authorities will have to hire more and more people?

Answer: Current legal regulations state that the local government has to appraise, or have appraised, the value of properties for the purpose of taxation. According to that law, the taxable value of the property should be the price attainable for the property on the market. In the interest of simplifying the process, the local government may establish the taxable value as, for example, the price of the property last January 1. In the interest of keeping down the costs of appraisal and avoiding the swelling of the tax office and staff, the local government can use so-called mass appraisal, meaning that appraisal is not done case-by-case. This simplifies the process, and ensures that the established value meets legal requirements. This technique makes possible the regular re-appraisal of properties.

Inequalities Among Settlements

Question: Homes in Budapest, particularly in parts of Buda, are more expensive than those in the provinces, most obviously in the eastern part of the country. Accordingly, will the introduction of property taxes make some local governments richer than others?

Answer: There are always some local governments which will be richer, as local circumstances are always unique. It is a fact that the 1:4 difference ratio in property values is considerably less than the 1:11 ratio experienced when calculating the per capita value of business tax. In addition, local governments of course are able to set different tax rates, reflecting house values as well as local government revenue needs and affordability. In the current local government system it is the responsibility of the central government to ease the consequences of inequality.

Question: If you think that the central government must secure further financial support for those local governments which will have lower revenues from collecting property tax, then you once again give the responsibility of redistribution to the state. What, then, makes this different from current practice?

Answer: In theory fiscal transfers—geared to making the budget equitable—must come from the central government. Redistribution functions cannot be taken on at the local level, as the diminishing of differences between local governments is the goal at hand. The responsibility should be in the hands of the central, or perhaps, where possible, regional governments. Further, fiscal transfers geared to making the budget equitable must take into account current local needs and potential local tax revenue. On

the other hand, local taxes have a different purpose: to fund local services. It makes most sense for those funds to be raised locally by the municipality itself

Question: What will happen to those local governments which will not gain enough revenue through this tax?

Answer: Property tax is not the only local revenue source. Other sources, including transfers from the central budget, do exist. In the end, local governments can only offer services which they can actually finance. The most important goal in introducing the taxes is to make up for financing deficiencies, and in such cases the goals and services to be earmarked for financing can be clearly defined.

The Use of Tax Revenues

Question: What will the local governments do with the new revenue? Should money be spent on developing education, or on other goals?

Answer: Significant tax levels will be levied only by those local governments which must do so in the interest of financing services to be offered. Basically, the new revenues are to help finance the offering of local services. Whether these revenues are turned to funding education or other services is a decision for the local government, and one which ought to be made based on the needs and preferences of the local community.

The Re-Taxation of Taxed Incomes

Question: Don't you feel it is unjust to tax one's property when the income used to buy, renovate, and furnish that property has already been heavily taxed, and that these expenses were already subject to an enormous VAT?

Answer: This is not really dual taxation, because the property tax is not a house tax or a post-income tax or a wealth tax, but instead a way of paying for local services. Further, it is an equitable tax, because the value of property is more or less proportionate to the level of the use of services.

Business Tax Instead of Residential Tax

Question: Don't you think that the taxation of businesses would be a better way of raising revenue than taxing residents?

Answer: In the end people are taxed one way or another. Businesses compensate for tax payments by raising their prices. Actually, business tax is not progressive, as, through consumption, it burdens the poor at a higher rate than it affects better-off citizens. Further, entrepreneurs already pay local tax.



The Optimal Tax Rate

Question: How high should the property tax be?

Answer: It is difficult to generalize when discussing tax rates, because the optimal level differs among local authorities. It is up to local governments to decide what rates they should levy, in accordance with their own circumstances. Currently in Hungary the law states that the tax cannot be higher than 1.5 percent of the market value of the property. When establishing the tax rate the local governments must take into account not only their local revenue needs, but also the ability of local citizens to pay.

Inflating the Bureaucracy

Question: Don't you think that a more advanced local tax system will only increase the growth of the local bureaucracy?

Answer: International experience shows that the property tax system is relatively efficient. The local government controls its own revenues and is able to make the decisions which effect its constituents. The advantages far outweigh the costs of bureaucracy in establishing the new system. The method the local government uses to appraise properties makes it possible to establish a cheap, simple, transparent, equitable and just process, without inflating the local government's administrative staff.

Local Tax – Local Responsibility

Question: Don't you think that lowering the responsibilities of local governments would lead to minimizing local bureaucracy, and that the central government could see to these responsibilities more effectively?

Answer: Central government bureaucracy is not necessarily better than local bureaucracy. In fact, local bureaucracies are in closer contact with local residents and understand their concrete needs. A common argument is that citizens are better served by local governments and that local governments are more accountable for the quality of services. It is much simpler to stop and discuss a problem with the mayor on the street than it is to visit Parliament.

Question: Why is it important for citizens to deal with local government?

Answer: If people are not concerned with what is being done with their money, then transparency and accountability become unimportant. Generally people are unconcerned with local government when its revenues are not local. And this is one of the arguments for property tax: it is a local tax. When citizens pay the local government

directly, they will be more concerned about what the money is spent on, and then accountability and transparency will gain in significance.